AGENDA ITEM NO 12

TREASURY OPERATIONS MID YEAR REVIEW

Committee: Finance & Governance Committee

Date: 20 December 2012

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[M192]

1.0 ISSUE

1.1 To provide Members with an update on the Council's current 2012/13 Treasury position.

2.0 RECOMMENDATIONS

2.1 That Members be requested to note the mid year review of the Council's treasury management for 2012/13, as set out at Appendices 1 and 2 (to 30 November 2012).

3.0 BACKGROUND

3.1 The Chartered Institute of Public Finance and Accountancy (C.I.P.F.A.) Revised Code of Practice on Treasury Management requires this Council to adopt the revised Code and fully comply with its requirements.

3.2 This report complies with the requirement for a mid year review.

3.3 The Council's 2012/13 Treasury Management Strategy was based on an expectation that Bank Rate, having fallen to 0.50% in January 2009, would remain at that rate throughout 2012/13. The target average investment return was expected to be 0.70%.

3.4 Bank rate has remained at 0.50% but is now not expected to rise until early 2015. This is due to the Bank of England changing its position significantly in the August Inflation Report when it markedly downgraded its forecasts for the strength and speed of recovery in GDP (Gross Domestic Product) growth.

3.5 The interest receipts generated on the investments during the year to date is £89,192, against an original budget of £90,000, producing an average return on investments of 0.80%. This is significantly above the benchmark one month LIBID (London Inter-Bank Bid Rate) of 0.53%, due to the Council taking advantage of its business reserve which have continued to pay higher than market rates for short-term investments. However one bank has recently reduced its rates significantly (from 0.8% to 0.4% for a 35 day notice account) and the remaining banks may do so in due course.

3.6 Despite current interest rate forecasts, interest received on investments is forecast to be£50,000 higher than originally estimated by year-end.

3.7 There has been no short or long-term borrowing in 2012/13 to date.

3.8 The Council's treasury advisers Sector recommended on 8 September 2011 that all investments be temporarily restricted to a maximum 3-month duration due to the Euro zone issues. This restriction is still in effect and consequently the ratings of counterparties on Sector's list remain reduced to green (3 months). This excludes UK government supported organisations, which remain as a maximum 1-year duration (blue rating) and local authorities and the UK Government which are a maximum 5-year duration (yellow rating).

3.8.1 Counterparties are usually colour rated by Sector for the following durations:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

3.9 The use of Money Market Funds (MMF's) was approved in the 2011/12 Strategy and will be investigated further, as there is the possibility that some counterparties currently used by the Council may be downgraded and not meet the Council's criteria.

3.10 Also the Council anticipates receiving £4m in 2013/14 to fund changing both recycling and organics collection services to wheeled bins. Additional income will need to be invested until expenditure occurs and MMF's would currently offer a higher interest rate than any other option available to the Council.

4.0 <u>CONCLUSIONS</u>

4.1 The size of the Council's investment portfolio is relatively small meaning that investment decisions have to be made primarily to accommodate cash flow requirements as opposed to optimising investment returns. Despite these pressures, opportunities for some proactive investment decisions have been taken which will be kept under review and further opportunities taken where appropriate.

4.2 In 2012/13 new investments have been mainly shorter term and business reserve accounts used significantly as their rates are higher than short-term

market rates. The Council has so far exceeded the 1-month LIBID benchmark in previous years as well as 2012/13 to date. However with lower interest rates, the percentage above the benchmark has decreased.

4.3 During 2012/13 the Council has operated within its approved treasury limits and Prudential Indicators.

4.4 In 2012/13 no long-term borrowing is planned. Borrowing will only be undertaken short-term for cash flow purposes if required.

4.5 As at 30 November, the Council had investments with 7 financial institutions totalling nearly £16,000,000. The maturity dates of these investments ranged from instant access (accounts) to November 2013. See Appendix 2 for further details.

4.6 The current investment rates on offer to the Council are:

- Business reserve accounts – 0.25% to 1.45%
- DMADF (Government account) – 0.25% overnight to 6 months
- Money market deposits – 0.25% overnight to 2.25% for 1 year

5.0 FINANCIAL IMPLICATIONS/EQUALITY IMPACT ASSESSMENT

5.1 The cost implications arising from this report relate to the potential increase in investment interest income in 2012/13. The budgets for 2013/14 onwards will be reviewed as part of the budget setting process and will reflect Sector's forecast average investment interest, which is currently 0.50% for 2013/14.

5.2 An Equality Impact Assessment (INRA) is not required.

6.0 APPENDICES

6.1 Appendix 1: Mid Year Review
Appendix 2: Current Investments

Background Documents	Location	Contact Officer
Strategic Policy & Resources Committee 26 January 2012 and Finance & Governance Committee 27 September 2012	Room 204 The Grange Ely	Ann Hughes Senior Accountancy Assistant (01353) 616270 E-mail: ann.hughes@eastcambs.gov.uk
Sector's Revised Interest Rate Forecast		
Treasury Register		

Mid Year Review **Appendix 1**

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1 Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensures that this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure the Council

can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

As a consequence treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

2 Introduction

This Council adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) on 23 February 2010. The Code was further revised in 2011 and this committee and Full Council will be recommended to adopt this version for the 2013/14 Treasury Management Strategy.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the Full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision (MRP) Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Finance & Governance Committee.

   This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- An economic update for the first six months of 2012/13;

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2012/13;
- A review of the Council's borrowing strategy for 2012/13;
- A review of compliance with Treasury and Prudential Limits for 2012/13.

3 Economic update

3.1 Economic performance to date

Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. It was noted that the UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone, and that on-going negative sentiment in that area would inevitably permeate into the UK's economic performance.

With regard to the Eurozone, investor confidence remains weak because successive "rescue packages" have first raised, and then disappointed, market expectations. However, the uncertainty created by the continuing Eurozone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China.

In the UK, consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking a toll. Whilst inflation has fallen considerably (CPI - Consumer Price Index - @ 2.6% in July), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession. This means that the UK's recovery from the initial 2008 recession has been the worst and slowest of any G7 country apart from Italy (G7 = US, Japan, Germany, France, Canada, Italy and UK). It is also the slowest recovery from a recession of any of the five UK recessions since 1930 and total GDP is still 4.5% below its peak in 2008.

This weak recovery has caused social security payments to remain elevated and tax receipts to be depressed. Consequently, the Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed back further into the future. The MPC (Monetary Policy Committee) has kept Bank Rate at 0.5% throughout the period while quantitative easing was increased by £50bn to £375bn in July. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested

in and gilt yields, prior to the ECB (European Central Bank) bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

3.2 Outlook for the next six months of 2012/13

The risks in economic forecasts continue unabated from the previous treasury strategy. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is hamstrung by political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required early in 2013 to address the US debt position. However, on 13 September the Fed. (U.S. Federal Bank) announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid 2015.

Eurozone growth will remain weak as austerity programmes in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it has failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. There is the distinct possibility that some of the northern European countries could push for the ejection of Greece from the Eurozone unless its financial prospects improve, which does not seem likely at this juncture. A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the ECB announced that it would purchase unlimited amounts of shorter term bonds of Eurozone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions (which have yet to be set) and include supervision from the (IMF) International Monetary Fund. This resulted in a surge in confidence that the Eurozone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether the politicians in charge of Spain and Italy will accept such loss of sovereignty in the light of the verdicts that voters have delivered to the politicians in other peripheral countries which have accepted such supervision and austerity programmes. The Eurozone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous “solutions” to the Eurozone crisis.

The Bank of England Quarterly Inflation Report in August pushed back the timing of the return to trend growth and also lowered its inflation expectations. Nevertheless, concern remains that the Bank’s forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world headwinds the UK economy faces. Weak export markets will remain a drag on the economy and consumer expenditure will continue to be depressed due to a focus on paying down debt, negative economic sentiment and job fears. The Coalition Government, meanwhile,

is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

The overall balance of risks is, therefore, weighted to the downside:

- Low growth in the UK is expected to continue, with Bank Rate unlikely to rise in the next 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB (Public Works Loan Board) borrowing rates is for them to eventually rise, primarily due to the need for a high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, tempering any increases in yield.
- This interest rate forecast is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Eurozone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.

3.3 Sector's interest rate forecast

	Nov-12 actual	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
3m LIBID	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.70	0.90	1.10	1.40
6m LIBID	0.85	0.85	0.85	0.85	0.85	0.85	1.00	1.10	1.30	1.50	1.80
12m LIBID	1.30	1.30	1.30	1.30	1.40	1.50	1.70	1.90	2.10	2.30	2.60
5yr PWLB	1.66	1.50	1.50	1.50	1.60	1.60	1.70	1.70	1.80	2.00	2.20
10yr PWLB	2.64	2.50	2.50	2.50	2.60	2.60	2.70	2.70	2.80	3.00	3.20
25yr PWLB	3.88	3.70	3.80	3.80	3.80	3.80	3.90	3.90	4.00	4.10	4.30
50yr PWLB	4.04	3.90	4.00	4.00	4.00	4.00	4.10	4.10	4.20	4.30	4.50

In the Budget 2012 the Government announced that they would introduce a 20 basis points (0.20%) discount on loans from the PWLB.

The above Sector forecasts for PWLB rates incorporates this introduction of the **PWLB certainty rate** in November 2012, which reduces PWLB borrowing rates by 0.20% for most local authorities. However this reduction does not apply to this Council as long-term borrowing was not required for its capital spending plans.

4 Treasury Management Strategy Statement and Annual Investment Strategy update

This Council approved the Treasury Management Strategy Statement (TMSS) for 2012/13 on 26 January 2012.

There are no policy changes to the TMSS, the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5 The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

	2012/13 Original Estimate £000	Current Position (31.10.12) £000	2012/13 Revised Estimate £000
Capital Expenditure	1,134	396	1,485

The difference between the Original and Revised Estimates is mainly due to:

Slippage from 2011/12 £380,000;

Slippage to 2013/14 £112,000;

Additional funding £5,000; and

Additions to programme £55,000 to purchase part of a car park.

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision - MRP), equivalent to the embedded lease payments.

Capital Expenditure	2012/13 Original Estimate £000	Current Position £000	2012/13 Revised Estimate £000
Total spend	1,134	396	1,485
Financed by:			
Capital receipts	0	0	2
Capital grants	406	211	564
Capital reserves	547	85	748
Revenue	181	100	171
Total financing	1,134	396	1,485
Borrowing need	0	0	0

The difference between the Original and Revised Estimates is mainly due to:

Capital receipts have increased by £2,000 due to anticipated mortgage repayments;

Additional funding £15,000;

Unspent capital grants £250,000 carried forward from 2011/12 and £112,000 to 2013/14; and

Use of capital reserves increased to cover the balance of the additional expenditure shown in the table at 5.1.

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

This Council is on target to achieve the original forecast Capital Financing Requirement.

Prudential Indicator – External Debt / the Operational Boundary

The Operational Boundary depicts the envisaged maximum level of external debt based upon cash flow forecasts.

	2012/13 Original Estimate £000	2012/13 Revised Estimate £000
Prudential Indicator – Capital Financing Requirement		
Total CFR	118	118
Net movement in CFR		0
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	0	0
Other long term liabilities*	132	132
Total debt 31 March	132	132
Operational Boundary**	250	250

* This is due to the embedded leases for the refuse and recycling vehicles and is equivalent to the embedded lease payments in the year.

** Equivalent to the opening CFR at the beginning of the year before embedded lease payments are deducted.

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a

capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2012/13 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2012/13 Original Estimate £000	2012/13 Revised Estimate £000
Gross borrowing	0	0
Plus other long term liabilities*	132	132
Less investments	(5,600)	(11,000)
Net borrowing	(5,468)	(10,868)
CFR* (year end position)	118	118

* On balance sheet finance leases - embedded leases for the refuse and recycling vehicles.

The Head of Finance reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2012/13 Original Indicator	2012/13 Revised Indicator
Borrowing	4,750	4,750
Other long term liabilities*	250	250
Total	5,000	5,000

* On balance sheet finance lease - embedded leases for the refuse and recycling vehicles.

6 Investment Portfolio 2012/13

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 3, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. The continuing

Euro zone sovereign debt crisis, and its potential impact on banks, prompts a low risk and short term strategy. Given this risk adverse environment, investment returns are likely to remain low.

The Council held £15.8m of investments as at 30 November 2012 (£9.9m at 31 March 2012) and the investment portfolio yield for the first seven months of the year is 0.80% against the benchmark (1 month LIBID) of 0.53%.

A full list of investments held as at 30 November 2012 is in appendix 2.

The Head of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first seven months of 2012/13.

The Council's budgeted investment return for 2012/13 is £140,000. This has recently been increased by £50,000 to meet current expectations of outturn.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

7 Borrowing

The Council's capital financing requirement (CFR) for 2012/13 is £118,000. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 5.4 shows the Council has no borrowings and has not used cash flow funds in lieu of borrowing. The Council remains debt free.

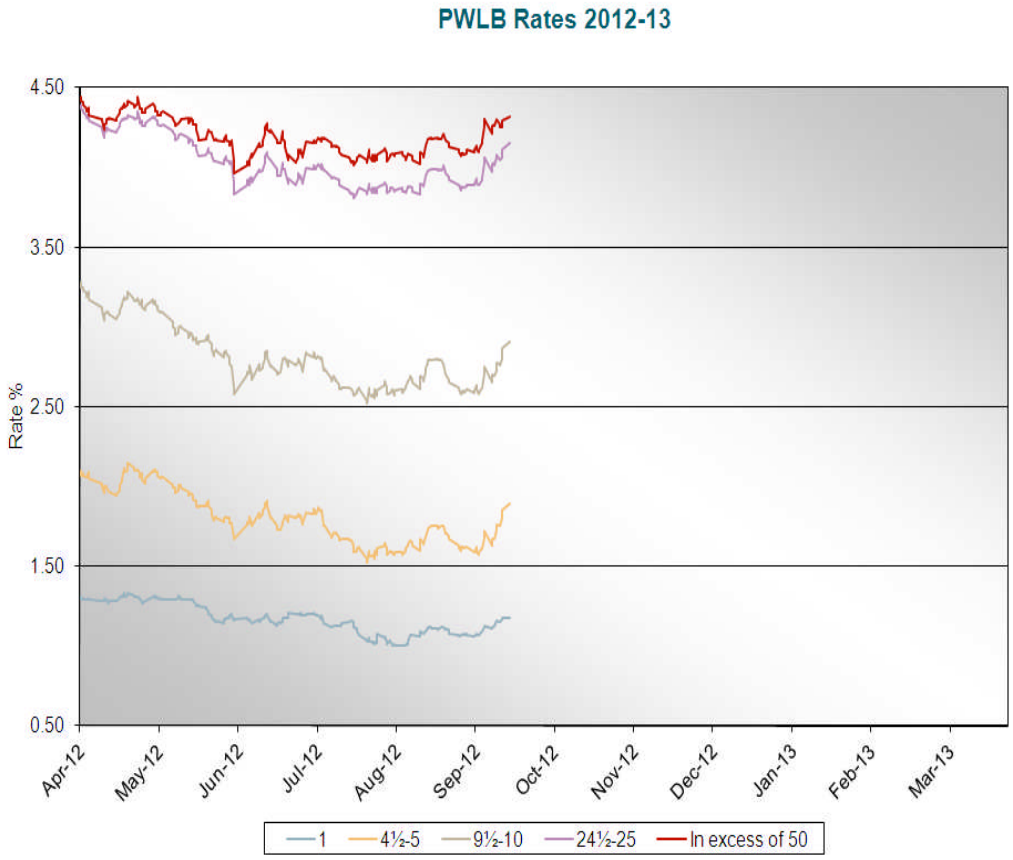
As outlined below, the general trend has been a reduction in PWLB interest rates during the first six months of 2012/13, across all maturity bands.

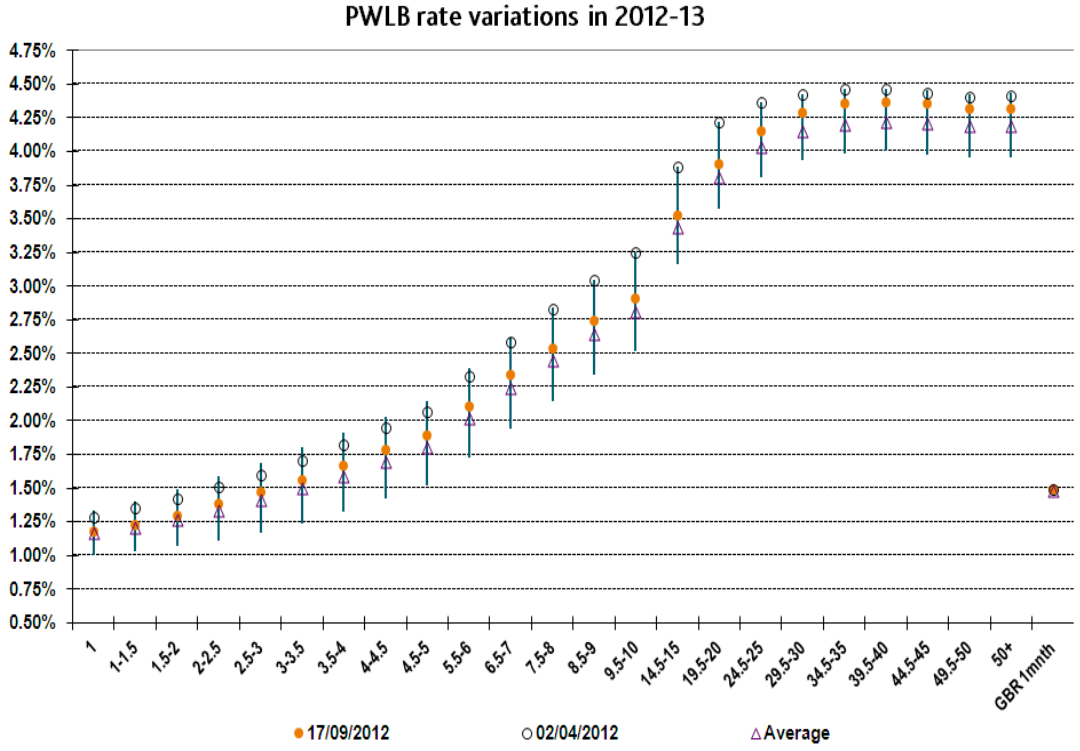
It is anticipated that borrowing will not be undertaken during this financial year, unless required short-term for cash flow purposes.

The graphs and table below show the movement in PWLB rates for the first six months of the year (to September 2012).

PWLB rates

	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	GBR 1mnth	
High	1.330%	1.400%	1.690%	1.910%	2.150%	3.250%	4.370%	4.430%	1.500%	High
Dates	20/04/2012	20/04/2012	20/04/2012	20/04/2012	20/04/2012	02/04/2012	02/04/2012	24/04/2012	18/04/2012	Dates
Low	1.000%	1.030%	1.170%	1.320%	1.520%	2.520%	3.810%	3.960%	1.450%	Low
Dates	02/08/2012	02/08/2012	23/07/2012	23/07/2012	23/07/2012	23/07/2012	18/07/2012	01/06/2012	01/08/2012	Dates
Average	1.171%	1.211%	1.410%	1.592%	1.801%	2.816%	4.032%	4.190%	1.478%	Average
Spread	0.330%	0.370%	0.520%	0.590%	0.630%	0.730%	0.560%	0.470%	0.050%	Spread




PWLB rate variations in 2012-13
4.75%
4.50%
4.25%
4.00%
3.75%
3.50%
3.25%
3.00%
2.75%
2.50%
2.25%
2.00%
1.75%
1.50%
1.25%
1.00%
0.75%
0.50%
1
1-1.5
1.5-2
2-2.5
2.5-3
3-3.5
3.5-4
4-4.5
4.5-5
5.5-6
6.5-7
7.5-8
8.5-9
9.5-10
14.5-15
19.5-20
24.5-25
29.5-30
34.5-35
39.5-40
44.5-45
49.5-50
50+
GBR 1mnth
17/09/2012
02/04/2012
Average