Gedling Borough Council

Report to Cabinet

Subject: Prudential Code Indicator Monitoring Q2 2012/13 and Quarterly Treasury Activity Report Q2 (30 September 2012)

Date: 8 November 2012

Author: Corporate Director (Chief Financial Officer)

Wards Affected

Not applicable

Purpose

To inform Members of the performance monitoring of the 2012/13 Prudential Code Indicators, and to advise Members of the quarterly treasury activity as required by the Treasury Management Strategy.

CIPFA's revised Code of Practice for Treasury Management recommends that members should be informed of Treasury Management activities at least twice a year, and preferably quarterly. The Council have long adopted this "best practice", and is fully compliant with the revised Code. This 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 interest rates
- A review of compliance with Prudential and Treasury Limits for 2012/13
- A review of the Integrated Treasury Management Strategy Statement and Annual Investment Strategy and Minimum Revenue Provision Policy Statement
- A review of any debt rescheduling undertaken during 2012/13

Key Decision

This is not a Key Decision

Background

1.1 It is a statutory duty under the Local Government Act 2003 (the Act) and its supporting regulations for the Council to determine and review how much it can afford to borrow. The Act introduced the Prudential Framework for Local Authority Capital Investment, the key objectives being:

- That capital investment plans are affordable, prudent and sustainable.
- That treasury management decisions are taken in accordance with good professional practice.

Further information on the subject of this report is available from Alison Ball, Financial Services Manager, on (0115) 901 3980 or Sue Healey, Principal Accountant, on 0115 901 3856

- That local strategic planning, asset management and proper option appraisal are supported.

1.2 To demonstrate that these objectives have been fulfilled, the Prudential Code details the various Prudential and Treasury Management indicators that must be set and monitored. These indicators are designed to support and record local decision-making, and not to be comparative performance indicators.

1.3 Consideration was given by Cabinet to the Prudential Indicators for 2012/13 to 2014/15 at its meeting on 16 February and referred for approval by Full Council on 5 March 2012.

1.4 The Prudential Code requires the Chief Financial Officer to establish procedures to monitor performance against all forward-looking prudential indicators, and to report any significant deviations from expectations.

Proposal

2.1 Economic Update at Quarter 2

Prospects for a swift UK recovery from recession suffered a 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.

With regard to the Eurozone, investor confidence remains weak because successive “rescue packages” have first raised, and then disappointed, market expectations. 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 and China.

In the UK, consumer confidence remains 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 was 2.6% in July), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession.

The weak recovery has caused social security payments to remain high 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 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.

In spite of much bad news, the UK’s sovereign debt remains a relatively safe haven for surplus cash and gilt yields, prior to the ECB bond buying announcement in early September, were close to zero for periods out to five years and only a little higher out to ten years.
The risks in economic forecasts continue unabated. Concern has escalated that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while

America is hampered by political deadlock which prevents a positive approach to countering weak growth.

Eurozone growth is likely to remain weak as austerity programmes curtail economic recovery. A further crisis is rapidly developing in Greece, as it has failed again to achieve deficit reduction targets and so may yet require a third bail out. There is a distinct possibility that some of the northern European countries may push for the ejection of Greece from the Eurozone unless its financial prospects improve, which does not seem likely at this time.

A financial crisis was also 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 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 Spain and Italy will accept such loss of sovereignty. The Eurozone crisis is therefore far from being resolved.

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. Concern remains that the Bank's forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world conditions faced by the UK economy. 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 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.

Current interest rate forecasts are 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 these forecasts.

2.2 Interest Rate Forecasts

The Council's treasury adviser, Sector, periodically provides interest rate forecasts for use by its clients. The latest forecast was received on 17 September and is reproduced below.

In the Budget of March 2012, it was announced that the Government would introduce a 20 basis point discount on PWLB loans for those authorities providing improved information and transparency on their long term borrowing and associated capital spending plans. The forecast below takes account of this discount, or "certainty rate", which will be effective from 1 November 2012.

	17/9 Actual	Dec 2012	Mar 2013	Jun 2013	Sep 2013	Dec 2013	Mar 2014	Jun 2014	Sep 2014	Dec 2014	Mar 2015
Bank Rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
3 month LIBID	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.70	0.90	1.10	1.40
6 month LIBID	0.85	0.85	0.85	0.85	0.85	0.85	1.00	1.10	1.30	1.50	1.80
12 month 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	1.89	1.50	1.50	1.50	1.60	1.70	1.80	1.90	2.00	2.10	2.30
10Yr PWLB	2.91	2.50	2.50	2.50	2.60	2.70	2.80	2.90	3.00	3.20	3.30
25Yr PWLB	4.15	3.70	3.70	3.70	3.80	3.80	3.90	4.00	4.10	4.20	4.30
50Yr PWLB	4.32	3.90	3.90	3.90	4.00	4.00	4.10	4.20	4.30	4.40	4.50

2.3 Compliance with the Treasury and Prudential Indicators

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the Treasury Management Strategy Statement (TMSS) approved by Council on 5 March 2012.

During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the council's TMSS, and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators as at 30 September 2012 are shown at Appendix 1.

2.3.1 Prudential Indicators

These are based on estimates of expected outcomes, and are key indicators of "affordability". They are monitored on a quarterly basis, and Appendix 1 compares the approved indicators with the projected outturn for 2012/13, and shows variances on some of the indicators, as described below:

i) Capital Expenditure

The latest projected outturn shows that capital expenditure is expected to be £5,062,000. This is higher than the original estimate of £3,958,200 due to the inclusion of approved carry-forward requests from 2011/12, and to the additions to the programme currently being proposed to Cabinet.

ii) Ratio of Financing Costs to Net Revenue Stream

The projected outturn of 5.23% shows a reduction from the approved indicator of 6.46%. This is due both to a reduction in MRP as a result of slippage on the capital programme in 2011/12, and to higher than anticipated investment interest in 2012/13 due to the timing of some advantageous fixed rates and rigorous cashflow management.

iii) Capital Financing Requirement (CFR)

The projected closing CFR for 2012/13 is £12,949,409. This is slightly lower than the approved indicator of £13,095,100.

iv) Net Borrowing Requirement and CFR

This indicator seeks to ensure that borrowing over the medium term is only for capital purposes. Outstanding net borrowing should at no time exceed the opening capital financing requirement plus the anticipated movements in CFR in the current and following two years.

2.3.2 Treasury Management Indicators

These are based on limits, beyond which activities should not pass without management action. They include two key indicators of "affordability" and four key indicators of "prudence".

"Affordability"

i) Authorised Limit for External Debt.
ii) Operational Boundary for External Debt.

"Prudence"

iii) Upper Limit for Fixed Interest Exposure – represented by the maximum permitted net outstanding principal sum borrowed at fixed rates. Please note that a negative indicator represents net investment.

iv) Upper Limit for Variable Interest Rate Exposure – represented by the maximum permitted net outstanding principal sum borrowed at variable rates. Please note that a negative indicator represents net investment.

v) Upper limits for principal sums invested for periods over 364 days - two investments for periods over 364 days were brought forward at 1 April 2012 and a further investment was made during quarter 1. All three mature after 31 March 2013 but before 31 March 2014, and amount to £4.5m in total.

These investments are classified as a “non specified investments” by way of their initial terms (over 364 days), however they are within both the Treasury Indicator of £5m, and the limits set out for non specified investments in the Annual Investment Strategy approved by Members on 5 March 2012.

vi) Upper limits for the maturity structure of borrowing.

Appendix 1 shows the actual position as at 30 September 2012, and demonstrates that all activities are contained within the currently approved limits.

2.4 Mid-Year Review of the Integrated Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy Statement 2012/13

The Integrated Treasury Management Strategy Statement (TMSS), Annual Investment Strategy and Minimum Revenue Provision Policy Statement for 2012/13 was approved by Council on 5 March 2012. This document covered both the borrowing and investment strategies for the year, together with the council’s intentions with regard to MRP.

2.5 Borrowing Strategy

No new long-term borrowing was undertaken during the quarter ended 30 September 2012.

The council’s Capital Financing Requirement (CFR) represents its underlying need to borrow to finance capital investment. Due to favourable interest rates, borrowing in advance of need is sometimes desirable, with the result that the CFR can differ to the actual borrowing planned in the year.

The latest projection of the requirement for borrowing in 2012/13 is £3,239,100, however in view of the borrowing undertaken in advance of need during 2011/12, it is not currently anticipated that any new borrowing will be undertaken during the year.

Interest rates remain low, and as discussed above, the Budget 2012 introduced the PWLB “certainty rate”, whereby authorities providing transparency information regarding their borrowing and capital expenditure plans would be able to take advantage of a discount of 20 basis points. Advice will therefore be taken from Sector with regard to additional borrowing. Should conditions be advantageous, some further borrowing in advance of need will be considered by the Chief Financial Officer.

2.6 Investment Strategy

The council’s investment priorities remain the security of capital and good liquidity. The council will always seek to obtain the optimum return (yield) on its investments, but only that commensurate with proper levels of security and liquidity. In the current economic climate and the heightened credit concerns, it is considered appropriate either to keep investments short–term, or to extend the period to one year or more with selected government-backed counterparties. Whilst call accounts are paying around 0.8%, rates in excess of 2% can be achieved on fixed term deposits.

The Treasury Activity Report for the quarter ended 30 September 2012 is attached at Appendix 2, in accordance with the Treasury Management Strategy. For reference, definitions of LIBOR and LIBID are given at Appendix 3.

Members will note that an equated rate of 2.21% has been achieved to 30 September, which outperforms both the 7 day and 3 month LIBID rates of 0.43% and 0.74% respectively. This has been achieved by mixing the use of call account investments with some longer term-deposits, with government supported institutions, at favourable rates, in accordance with the strategy discussed above. The rates achieved have been significantly better than those projected, generating additional income of £97,000 for the Council.

To allow risk to be spread still further, arrangements have recently been made to open a Money Market Fund, an AAA rated investment vehicle which allows the pooling of many billions of pounds of funds into a highly diversified fund. Returns, whilst not spectacular, should be in excess of overnight treasury deposit rates.

Credit ratings advice continues to be taken from Sector, however the ultimate decision on what is prudent and manageable for this council is taken by the Chief Financial Officer under the approved scheme of delegation.

2.7 Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate, and due to the structure of interest rates following the increases in PWLB rates in October 2010. Advice in this regard will continue to be taken from Sector.

No debt rescheduling was undertaken during the three months to 30 June 2012.

Alternative Options

3. There are no Alternative Options, this report being a requirement of the Council's Treasury Management Strategy Statement (TMSS).

Financial Implications

4. No specific financial implications are attributable to this report.

Appendices

5. Appendix 1 - The Prudential and Treasury Indicators as at 30 September 2012
Appendix 2 - Treasury Activity Report 2012/13 for Quarter ended 30 September 2012
Appendix 3 - Definitions of LIBOR and LIBID

Background Papers

6. None identified.

Recommendation

THAT: Members note the report, together with the Prudential Indicator Monitoring at Appendix 1, and the Treasury Activity Report at Appendix

Reasons for Recommendations

7. To comply with the requirements of the Treasury Management Strategy Statement.

APPENDIX 1

Prudential and Treasury Indicators for 2012/13
Position at 30 September 2012

Prudential Indicators

		2012/13 Original Est (Council 5/3/12)	2012/13 Position at 30 September 2012
a)	Capital Expenditure	£3,958,200	£5,062,000
b)	Ratio of Fin'g Costs to Net Revenue. Stream	6.46%	5.23%
c)	Capital Financing Requirement (CFR)	£13,095,100	£12,949,409
d)	Net Borrowing and CFR	£14,207,400	£2,938,423
e)	Incremental impact of new 2012/13 capital investment decisions	£0.57	Not Applicable

Treasury Management Indicators

		2012/13 Original Est (Council 5/3/12)	2012/13 Position at 30 September 2012
a)	Authorised Limit for External Debt:		
	Borrowing	£16,200,000	£10,811,577
	Other Long Term Liabilities	£1,500,000	-
	Total Authorised Limit	**£17,700,000**	**£10,811,577**
b)	Operational Boundary for External Debt:		
	Borrowing	£15,200,000	£10,811,577
	Other Long Term Liabilities	£1,500,000	-
	Total Operational Boundary	**£16,700,000**	**£10,811,577**
c)	Upper limit for fixed interest exposure (Max o/s net Borrowing)	£14,200,000	£2,811,577
	Local indicator-Investment only	100%	58.18%
	Local indicator-Borrowing only	100%	100.0%
d)	Upper limit for variable interest exposure (Max o/s net Borrowing)	£2,000,000	Nil
	Local indicator-Investment only	100%	41.82%
	Local indicator-Borrowing only	50%	0.00%
e)	Upper limits for maturity structure of outstanding borrowing during 2012/13 (Lower limits 0%)		
	Under 1 year	20%	0.0%
	1-2 years	25%	0.0%
	2-5 years	50%	37.0%
	5-10 years	50%	0.0%
	Over 10 years	100%	63.0%
f)	Upper limits for outstanding principal sums **initially** invested for periods **over** 364 days		
	Maturing beyond 31 March 2013	£5,000,000	£4,500,000
	Maturing beyond 31 March 2014	£3,000,000	£0
	Maturing beyond 31 March 2015	£1,000,000	£0

APPENDIX 2

Treasury Activity Report 2012/13 for the Quarter ended 30 September 2012

	Position at 1 July 12	Loans Made Quarter 2	Loans Repaid Quarter 2	Position at 30 Sept 12
	£	£	£	£
Long Term Borrowing				
PWLB	**10,811,577**	**0**	**0**	**10,811,577**
Temporary Borrowing				
Local Authorities	0	0	0	0
Central Government	0	0	0	0
Banks and other Institutions	0	0	0	0
Total Temporary Borrowing	**0**	**0**	**0**	**0**
TOTAL BORROWING	**10,811,577**	**0**	**0**	**10,811,577**
Temporary Investment				
Bank of Scotland	(8,000,000)	(1,500,000)	2,500,000	(7,000,000)
Barclays	(1,000,000)	0	0	(1,000,000)
HSBC Treasury	0	(1,100,000)	1,100,000	0
Royal Bank of Scotland	0	(25,020,000)	19,270,000	(5,750,000)
Total Banks	**(9,0000,000)**	**(27,620,000)**	**22,870,000**	**(13,750,000)**
Building Societies	0	0	0	0
Debt Management Office	0	0	0	0
Local Authorities and Others	0	0	0	0
TOTAL INVESTMENT	**(9,000,000)**	**(27,620,000)**	**22,870,000**	**(13,750,000)**
NET BORROWING / (INVESTMENT)	**1,811,577**	**(27,620,000)**	**22,870,000**	**(2,938,423)**

Temporary Investment and Borrowing Statistics at 30 September 2012:

Investment				
Fixed Rate	(9,000,000)	(2,600,000)	3,600,000	(8,000,000)
Variable Rate	0	(25,020,000)	19,270,000	(5,750,000)
TOTAL INVESTMENT	**(9,000,000)**	**(27,620,000)**	**22,870,000)**	**(13,750,000)**

Proportion of Fixed Rate Investment	58.18%
Proportion of Variable Rate investment	41.82%
Temporary Investment Interest Receivable	£109,274
Equated Temporary Investment	£4,947,452
Weighted Average Interest Rate Received	2.21%
7 Day LIBID (Benchmark) 30 Sept	0.43%
3 Month LIBID 30 Sept	0.74%

Borrowing

Temporary Borrowing Interest Payable	£268
Equated Temporary Borrowing	£88,083
Weighted Average Interest Rate Paid	0.30%
7 Day LIBOR (Benchmark) 30 Sept	0.55%

APPENDIX 3

LIBOR - the London Interbank Offered Rate

LIBOR is the interest rate at which the London banks are willing to offer funds in the inter-bank market. It is the average of rates which five major London banks are willing to lend £10 million for a period of three or six months, and is the benchmark rate for setting interest rates for adjustable-rate loans and financial instruments.

ie. the London banks are LENDING to each other, which affects the rate at which the banks will lend to other parties eg. local authorities, ie. Gedling are BORROWING money

LIBID - the Interbank BID (LIBID) rate

LIBID is the interest rate at which London banks are willing to borrow from one another in the inter-bank market. It is the average of rates which five major London banks willing to bid for a £10 million deposit for a period of three or six months.

ie. the London banks are BORROWING from each other, which affects the rates at which they will borrow from other parties eg. local authorities, ie. Gedling are LENDING money.