Gedling Borough Council

Report to Cabinet

Subject: Prudential Code Indicator Monitoring 2012/13 and Quarterly Treasury Activity Report for Quarter ended 31 December 2012

Date: 7 February 2013

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 be informed of the Council's Treasury Management activities at least twice a year, and preferably quarterly. The Council has long adopted this "best practice", and is fully compliant with the revised Code. This report has been prepared in compliance with the Code of Practice, and covers the following:

- An economic update
- A review of interest rates
- The Annual Investment Strategy
- New borrowing
- Debt rescheduling
- A review of compliance with Prudential and Treasury Limits for 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.

- 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 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 2012 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 3

The loss of the boost from the Olympic Games had a negative impact on GDP in the fourth quarter of 2012. Business surveys generally weakened, with the measure of services activity in December falling to its lowest level since December 2010. Following a 2.1% monthly drop in September, industrial production fell by a further 0.8% in October. The overall trade deficit widened from £2.5bn in September to £3.6bn in October.

High street spending was relatively weak, with the official measure of retail sales volumes falling by 0.7% in October and remaining stagnant in November. However, spending off the high street continued to show evidence of recovery. In particular, private new car registrations were 12% and 11% higher than a year ago in October and November respectively. This data indicate there is likely to have been a 0.4% quarterly fall in GDP in Q4 2012, which would leave growth for 2012 as a whole at about minus 0.1%.

The resilience of the labour market continued, though fading a little through the quarter. The claimant count measure of unemployment fell by 3,000 in November, while the Labour Force Survey measure of employment rose by 40,000 in the three months to October. Pay growth remained depressed. Annual growth of overall average earnings dropped from 1.8% in June to 1.3% in October. Given the rate of inflation over this period, real pay continued to fall on an annual basis.

The Halifax measure of house prices declined by 0.1% month on month in October, but then rose by 1% in November. However, the Nationwide's measure was flat in November, having risen by 0.6% in October. Mortgage approvals for new house purchase continued to rise.

Funding costs for the banks continued to ease over the quarter, reflecting the Bank of England's provision of low cost funding via the Funding for Lending Scheme.

Borrowing from April to November was £9bn higher than the same period in 2011/12. However, the Office for Budget Responsibility (OBR) expects net borrowing to come in at £108bn in 2012/13, about £10bn below last year's level, largely reflecting the receipt of funds from the Bank of England's Asset Purchase Facility and the anticipated auction of 4G licences.

The Autumn Statement produced few surprises. Austerity was extended for a further year, to 2017/18, and in light of the deterioration in the borrowing forecasts, the Chancellor chose to disregard one of his fiscal targets, to get debt as a share of GDP falling by 2015/16.

CPI inflation rose from 2.2% in September to 2.7% in October, and remained at that level in November. October's rise in university tuition fees, rises in utility prices at the end of the 2012 and a pick-up in food price inflation following poor harvests, mean that inflation is likely to remain between 2.5% and 3% for most of 2013. The MPC voted in November to pause its programme of quantitative easing, leaving total asset purchases at £375bn. The announcement in November that Mark Carney is to become Governor of the Bank of England in June 2013, raised speculation that the MPC's current 2% inflation target may be reformulated.

Equity prices in the UK and overseas largely continued to rise over the course of the Q4 2012, with the FTSE 100 picking up from 5,820 to 5,898. Over the period gilt prices fell, causing 10-year gilt yields to rise from about 1.55% to 1.80%. Meanwhile, the pound was unchanged against the dollar, at about $1.63, but weakened slightly against the euro from €1.25 to €1.23.

Internationally, the US economy's recovery has remained soft. A weighted average of the manufacturing and non-manufacturing ISM indices points to annualised GDP growth of 2.0% in Q4 2012. Total non-farm payroll employment rose by 138,000 in October and 146,000 in November, compared to an average increase of 168,000 in the third quarter. However, the agreement reached on 1st January to avert some of the "fiscal cliff" scheduled for the start of 2013 reduces the risk of a new recession.

In the Eurozone, market sentiment was steadied by the ECB's pledge to buy "unlimited" quantities of peripheral government's sovereign debt. However, activity indicators point to a deepening recession in the region..

2.2 Interest Rate Forecasts

The Council's treasury adviser, Sector, periodically provides interest rate forecasts for its clients' use. The latest forecast is reproduced below and takes account of the 20 basis point PWLB discount, or "certainty rate", which has been effective since 1 November 2012. This rate is applicable to authorities, including Gedling, providing improved information and transparency on their long term borrowing and associated capital spending plans.

Sector undertook a review of its interest rate forecasts following the issue of the latest Bank of England Inflation Report for November 2012. In the August Inflation Report, the Bank changed its position significantly, markedly downgrading its forecasts for the strength and speed of recovery in GDP growth. In its November Report, the Bank

continued this shift towards pessimism in the speed and strength of recovery, now only forecasting growth at around 1% in 2013 and 2% in 2014. These developments pushed back Sector's expectations of the timing of the start of increases in Bank Rate from Quarter 4 2014 to Quarter 1 2015, as well as the pace of rises in gilt yields.

The main rating agencies have all made it clear they will be reviewing the UK's "AAA" status in early 2013 and there is a material chance of the current ratings being downgraded. Although the UK will retain its "safe haven" status, a change in rating may place some upside pressure on gilt yields.

	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	0.75
5Yr PWLB	1.50	1.50	1.60	1.60	1.70	1.70	1.80	2.00	2.20
10Yr PWLB	2.50	2.50	2.60	2.60	2.70	2.70	2.80	3.00	3.20
25Yr PWLB	3.80	3.80	3.80	3.80	3.90	3.90	4.00	4.10	4.30
50Yr PWLB	4.00	4.00	4.00	4.00	4.10	4.10	4.20	4.30	4.50

2.3 Annual Investment Strategy

The Council's investment priorities remain the security of capital and good liquidity. Whilst the Council will always seek to obtain the optimum return (yield) on its investments, this will be 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.

Full use has been made of Call Account facilities paying around 0.75%-0.80%, and to allow risk to be spread further, a Money Market Fund was opened during Quarter 3. This is an AAA rated investment vehicle which allows the pooling of many billions of pounds worth of funds into a highly diversified fund. A return of around 0.40% is currently being achieved, which whilst not spectacular, is generally significantly in excess of overnight treasury deposit rates.

The Treasury Activity Report for the quarter ended 31 December 2012 is attached at Appendix 1, in accordance with the Treasury Management Strategy. For reference, definitions of LIBOR and LIBID are given at Appendix 2.

Members will note that an equated rate of 1.96% has been achieved to 31 December 2012. This is a little lower than the 2.21% achieved to 30 September, due both to favourable fixed loans maturing, and to rates in the market remaining very poor. However, the equated rate achieved still outperforms both the 7 day and 3 month LIBID rates of 0.41% and 0.62% by 1.55% and 1.34% respectively.

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

2.4 New Borrowing

No new long-term borrowing was undertaken during the quarter ended 31 December 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 (Q3) of the requirement for borrowing in 2012/13 is £2,218,400, 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 PWLB Certainty Rate discussed above allows the Council to take advantage of a discount of 20 basis points. Advice will therefore be taken from Sector with regard to any additional borrowing. Should conditions be advantageous, some further borrowing in advance of need will be considered by the Chief Financial Officer.

2.5 Debt Rescheduling

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

No debt rescheduling was undertaken during the three months to 31 December 2012.

2.6 Compliance with Prudential and Treasury Indicators

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limit. The Council's approved Prudential and Treasury 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 at all times 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 31 December 2012 are shown at Appendix 3.

2.3.1 Prudential Indicators

These indicators are based on estimates of expected outcomes, and are key indicators of "affordability". They are monitored on a quarterly basis, and Appendix 3 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 (Q3) shows that capital expenditure is expected to be £3,947,900. This differs to the original estimate of £3,958,200 by £10,300 due both to the inclusion of approved carry-forward requests from 2011/12, and to slippage of schemes planned for 2012/13 into 2013/14.

ii) Ratio of Financing Costs to Net Revenue Stream

The projected outturn of 5.32% 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 generated by some advantageous fixed rates, and rigorous cashflow management.

iii) Capital Financing Requirement (CFR)

The projected closing CFR for 2012/13 is £11,960,009. This is lower than the approved indicator of £13,095,100 due to the slippage of capital expenditure into 2013/14.

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. The position at 31 December is one of net investment.

2.3.2 Treasury Management Indicators

These indicators 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 outstanding principal sums originally invested for periods over 364 days – the current portfolio includes two such investments, totalling £3m. Both of these mature after 31 March 2013, but before 31 March 2014.

These investments are classified as a “non specified” by way of their initial terms exceeding 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 3 shows the actual position as at 31 December 2012, and demonstrates that all activities are contained within the currently approved limits.

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 - Treasury Activity Report 2012/13 for Quarter ended 31 December 2012
Appendix 2 - Definitions of LIBOR and LIBID
Appendix 3 - The Prudential and Treasury Indicators as at 31 December 2012

Background Papers

6. None identified.

Recommendation

THAT: Members note the report, together with the Treasury Activity Report for Quarter 3 at Appendix 1, and the Prudential and Treasury Indicator Monitoring for Quarter 3 at Appendix 3.

Reasons for Recommendations

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

APPENDIX 1

Treasury Activity Report 2012/13 for the Quarter ended 31 December 2012

	Position at 1 Oct 12	Loans Made Quarter 3	Loans Repaid Quarter 3	Position at 31 Dec 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	(7,000,000)	(1,500,000)	1,500,000	(7,000,000)
Barclays	(1,000,000)	(1,000,000)	1,000,000	(1,000,000)
HSBC Treasury	0	(23,280,000)	23,280,000	0
Ignis Money Market Fund	0	(8,770,000)	8,770,000	0
Royal Bank of Scotland	(5,750,000)	(5,920,000)	6,970,000	(4,700,000)
Total Banks	**(13,750,000)**	**(40,470,000)**	**41,520,000**	**(12,700,000)**
Building Societies	0	0	0	0
Debt Management Office	0	0	0	0
Local Authorities and Others	0	0	0	0
TOTAL INVESTMENT	**(13,750,000)**	**(40,470,000)**	**41,520,000**	**(12,700,000)**
NET BORROWING / (INVESTMENT)	**(2,938,423)**	**(40,470,000)**	**41,520,000**	**(1,888,423)**

Temporary Investment and Borrowing Statistics at 31 December 2012:

Investment

Fixed Rate	(8,000,000)	(25,780,000)	25,780,000	(8,000,000)
Variable Rate	(5,750,000)	(14,690,000)	15,740,000	(4,700,000)
TOTAL INVESTMENT	**(13,750,000)**	**(40,470,000)**	**41,520,000)**	**(12,700,000)**

Proportion of Fixed Rate Investment	62.99%
Proportion of Variable Rate investment	37.01%
Temporary Investment Interest Receivable	£171,520
Equated Temporary Investment	£8,754,385
Weighted Average Interest Rate Received	1.96%
7 Day LIBID (Benchmark) 31 Dec	0.41%
3 Month LIBID 31 Dec	0.62%

Borrowing

Temporary Borrowing Interest Payable	£268
Equated Temporary Borrowing	£88,083
Weighted Average Interest Rate Paid	0.30%
7 Day LIBOR (Benchmark) 31 Dec	0.53%

APPENDIX 2

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.

APPENDIX 3

Prudential and Treasury Indicators for 2012/13

Position at 31 December 2013

Prudential Indicators	2012/13 Original Est (Council 5/3/12)	2012/13 Position at 31 December 2012
a) Capital Expenditure	£3,958,200	£3,947,900
b) Ratio of Fin'g Costs to Net Revenue. Stream	6.46%	5.32%
c) Capital Financing Requirement (CFR)	£13,095,100	£11,960,009
d) Net Borrowing and CFR	£14,207,400	(£1,888,423)
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 31 December 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%	62.99%
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%	37.01%
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	£3,000,000
Maturing beyond 31 March 2014	£3,000,000	£0
Maturing beyond 31 March 2015	£1,000,000	£0