Gedling Borough Council

Report to Cabinet

Subject: Prudential Code Indicator Monitoring 2013/14 and Quarterly Treasury Activity Report for Quarter ended 30 September 2013

Date: 14 November 2013

Author: Corporate Director (Chief Financial Officer)

Wards Affected

All

Purpose

To inform members of the performance monitoring of the 2013/14 Prudential Code Indicators, and to advise members of the quarterly treasury activity as required by the Treasury Management Strategy.

Key Decision

This is not a key decision.

Background

1.1 The Council is required by regulations issued under the Local Government Act 2003 to report on its Prudential Code indicators and treasury activity. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 For 2013/14 the minimum reporting requirements are that the Full Council should receive the following reports:

- An annual treasury strategy in advance of the year (TMSS).
- A mid-year treasury update report
- An annual review following the end of the year describing the activity compared to the strategy.

In accordance with best practice, quarterly monitoring reports for treasury activity are provided to members, and that this exceeds the minimum requirements.

1.3 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report provides details of the position at 30 September and highlights compliance with the Council's policies.

Proposal

2.1 Economic update

Indicators at 30 September 2013 suggest that economic recovery has accelerated. Following expansion of 0.3% during Q1, the economy grew by 0.7% in Q2. Growth in household spending remained robust, with improvement in retail sales, mortgages, house prices and new car registrations.

Strengthening economic growth has supported the labour market, with employment rising at a modest pace, and unemployment reducing further. Pay growth has rebounded, however this has been largely driven by high earners delaying bonuses until after April's cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.3%, well below the rate of inflation, causing continuing pressure on household's disposable income.

The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened incentives for banks to extend more business funding, especially to small and medium size enterprises. To date however, the mortgage market still appears to have been the biggest beneficiary from FLS, with mortgage rates falling further. Demand in the housing market continues to grow, and mortgage approvals and house prices have both risen.

On an underlying basis, public borrowing in Q2 looked to be broadly in line with last year's figures, highlighting the Government's difficulty in reducing borrowing while economic growth was relatively lacklustre. The 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan, and monetary policy was unchanged in advance of the arrival of the new Bank of England Governor. Bank Rate remained at 0.5%, and quantitative easing stayed at £375bn. In August, the MPC provided "forward guidance" that Bank Rate is unlikely to change until unemployment falls to 7%, which is not expected until mid to late 2016. The three month to July average rate was 7.7%.

CPI inflation fell from a 2013 peak of 2.9% in June to 2.7% in August, due primarily to a fall in petrol prices. The Bank of England expects inflation to fall back to the MPC target of 2.0% in 2015.

Financial markets reacted sharply following a Federal Reserve (Fed) statement suggesting that it may 'taper' its asset purchases earlier than anticipated. The statement was a response to the improving economic outlook in the US. However, the Fed surprised markets on 18 September by deferring tapering, and emphasising that it would continue its extraordinary efforts to prop up the nation's recovery with billions of dollars in stimulus. During its post meeting news conference, Chairman of the Fed, Ben Bernanke, warned that the approaching showdowns over the federal budget and the debt ceiling could have dreadful consequences for the economy. He also cautioned that higher mortgage rates could choke the housing recovery. And although he cited "meaningful progress" in getting Americans back to work, he recognised that much of the decline in the unemployment rate was the result of people giving up looking for jobs, rather than a pickup in hiring.

Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a renewed flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to moderate growth in Q2, so ending six quarters of Eurozone recession.

2.2 Interest rate forecasts

Economic forecasting remains problematic with so many external influences weighing upon the UK. The overall balance of risk to economic recovery in the UK is now weighted to the upside, after five months of increasingly good news on the economy. However, the recovery is still fragile and exposed to vulnerabilities in a number of key areas. Near-term, the prospect of further quantitative easing (QE) is evenly balanced as the MPC weighs whether to take action to combat the market's expectations of an early first increase in Bank Rate.

Expectations for the first change in Bank Rate in the UK are now dependent on "how to forecast" when unemployment is likely to fall to 7%. Financial markets have taken a contrary view to the MPC, and have aggressively raised short term interest rates and gilt yields due to their view that the strength of economic recovery is now so rapid that unemployment will fall much faster than the Bank of England forecasts. Markets therefore expect the first increase in Bank Rate to be around Q3 of 2014. However, an opposing view is based on the fact that the economic downturn since 2008 has been remarkable for the way in which unemployment did not rise to anywhere near the extent thought likely, as in previous recessions. This meant that labour was retained, productivity fell, and now, as the MPC expects, there is major potential for a "near jobless recovery" as existing labour levels are worked more intensively and productivity rises back up again. With this view, the prospects for any increase in Bank Rate before 2016 are seen as being limited. Some forecasters even express a view that the Bank of England is too optimistic as to when the 7% level will be reached, so do not expect the first increase in Bank Rate until spring 2017.

In the light of the views above, the Council's treasury advisers, Capita Asset Services (re-branding of Sector in September 2013), have provided the following forecast:

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
5yr PWLB rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
10yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
25yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%
50yr PWLB rate	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.30%

2.3 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 with 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.

During the July to September period, significant use has been made of call account facilities paying around 0.70%, and of a Money Market Fund achieving around 0.38%. This fund is an AAA rated investment vehicle which allows the pooling of many billions of pounds worth of funds into a highly diversified fund. Whilst the rate of return is hardly spectacular, it is well in excess of overnight treasury deposit rates.

The Treasury Activity Report for the quarter ended 30 September 2013 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 1.39% has been achieved for the period to 30 September 2013, which outperforms both the 7 day and 3 month LIBID rates of 0.36% and 0.38% by 1.03% and 1.01% respectively. This has been achieved as a result of prudent investments made in 2012/13 however rates in the market are currently very poor, and as loans with favourable rates mature, it is becoming increasingly difficult to replace them. Accordingly, members are advised that the equated rate will inevitably drop further over the remainder of the year, since security and liquidity will always remain the overriding factors in the Council's treasury management.

Whilst a fall in investment rates was anticipated during the preparation of the budget for 2013/14, a reduction in the budget for investment income of £58,100 is now necessary due to rates remaining unfavourable. This is partly offset by a reduction of £38,000 in the budget for interest payable on borrowing, due to the internal borrowing strategy adopted in the current economic climate. Accordingly, the net interest cost to the General Fund increases by £20,100 from £168,800 to £188,900.

Credit ratings advice continues to be taken from Capita Asset Services, 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 30 September 2013.

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 <u>differ</u> to the actual borrowing planned in the year.

In view of borrowing previously undertaken in advance of need, it is not currently anticipated that <u>any</u> new borrowing will be undertaken during 2013/14.

Interest rates remain low, and the PWLB certainty rate, available to all authorities providing relevant information to CLG, allows the Council to take advantage of a discount of 20 basis points. Advice will be taken from Capita Asset Services with regard to the amount and timing of any additional borrowing, and should conditions become advantageous, some further borrowing in advance of need will also be considered by the Chief Financial Officer.

2.5 Debt rescheduling

Debt rescheduling opportunities are limited in the current economic climate, and due to the structure of interest rates. Advice in this regard will continue to be taken from Capita Asset Services.

No debt rescheduling was undertaken during the six months to 30 September 2013.

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 4 March 2013.

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 30 September 2013 are shown at Appendix 3.

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 2013/14, and shows variances on some of the indicators, as described below:

a) Prudential Indicators:

i) Capital Expenditure

The latest projected outturn shows that capital expenditure is expected to be £5,088,100. This differs to the original estimate of £4,396,700 due both to the inclusion of approved carry-forward requests from 2012/13, and to amendments to the capital programme for 2013/14.

ii) Capital Financing Requirement (CFR)

The projected closing CFR for 2013/14 is £13,999,800. This is lower than the approved indicator of £14,440,200 due to the above amendments to the capital programme and additional capital receipts becoming available.

iii) Ratio of Financing Costs to Net Revenue Stream

The projected outturn of 5.97% shows a reduction from the approved indicator of 6.37%. This is largely due to a reduction in MRP as a result of slippage on the capital programme in 2012/13.

iv) Maximum gross debt

The Council must ensure that its gross debt does not, except in the short term, exceed the opening capital financing requirement, plus estimates of any additional CFR for 2013/14 and the following two financial years. This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. Gross debt at 30

September was £10.812m.

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) Operational boundary for external debt.
ii) Authorised limit 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 a position of 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 a position of net investment.

v) Maximum new principal sums to be invested during 2013/14 for periods in excess of 364 days - such investments are classified as a “non specified”. This indicator is subject to the overall limit for non-specified investments set in the TMSS.

vi) Upper limits for the maturity structure of borrowing - set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing.

Appendix 3 shows the actual position as at 30 September 2013, and demonstrates that all activities are contained within the currently approved limits.

Alternative Options

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

Financial Implications

No specific financial implications are attributable to this report, adjustments to budgets for investment income and PWLB interest payable being dealt with in the revenue budget monitoring report elsewhere on this agenda.

Appendices

1. Treasury Activity Report 2013/14 for Quarter ended 30 September 2013.
2. Definitions of LIBOR and LIBID
3. The Prudential and Treasury Indicators as at 30 September 2013.

Background Papers

None identified.

Recommendation

That:

Members note the report, together with the Treasury Activity Report for Quarter 2 at Appendix 1, and the Prudential and Treasury Indicator Monitoring for Quarter 2 at Appendix 3.

Reasons for Recommendations

To comply with the requirements of the Council's Treasury Management Strategy Statement.

For more information, please contact:

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