Gedling Borough Council

Report to Cabinet

Subject: Prudential Code Indicator Monitoring 2013/14 and Quarterly Treasury Activity Report for Quarter ended 31 December 2014

Date: 13 February 2014

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 31 December and highlights compliance with the Council's policies.

Proposal

2.1 Economic update

UK growth was strong in Q2 and Q3 of 2013 at 0.7% and 0.8% respectively, and even faster growth is predicted for Q4. Forward surveys are also encouraging in terms of strong growth, and there are positive indications that recovery is broadening away from reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. Strong growth has resulted in unemployment falling much faster towards the threshold of 7%, set by the MPC before for consideration of any increases in Bank Rate. Accordingly, markets are expecting a first increase in early 2015, although recent comments from MPC members have emphasised the committee would want to see strong growth well established, and an increase in real incomes, before it would consider raising Bank Rate.

There has also been a sharp fall in inflation (CPI) to 2.1% in November and forward indications are that inflation will continue to be subdued. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and has fostered optimism for achieving a balance in the cyclically adjusted budget within five years, a year earlier than previously forecast.

In December, the Federal Reserve felt sufficiently confident that the premise for strong growth had been established in America that it could start to taper its asset purchases by reducing them by $10bn per month from January 2014. The encouraging growth scenarios in the USA and UK led to a sharp jump in December in short dated gilts, which accordingly, impacted 5 and 10 year PWLB rates.

2.2 Interest rate forecasts

Capita Asset Services Treasury Solutions (CASTS) undertook a review of its interest rate forecasts in late November 2013, after the Bank of England's latest quarterly Inflation Report. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016 and reflects greater caution with regard to the speed with which the MPC will start increasing Bank Rate than the current expectations of financial markets.

CASTS has provided the following forecast:

	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%	0.75%	1.00%	1.00%	1.25%
5yr PWLB rate	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.40%
10yr PWLB rate	3.60%	3.70%	3.80%	3.80%	3.90%	3.90%	4.00%	4.10%	4.20%	4.30%	4.30%	4.40%	4.50%
25yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.10%
50yr PWLB rate	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.20%

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth has rebounded during 2013 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are indicating that growth prospects are also strong for 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is encouraging as there needs to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for the recovery to become more firmly established. One drag on the economy is that wage inflation remains significantly below CPI inflation so disposable income and living standards are under pressure, however, income tax cuts have ameliorated this to some extent. Labour productivity must improve significantly before increases in pay rates are warranted. The US faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without too much damage to growth, although labour force participation rates remain lower than ideal.

With regard to the Eurozone, concerns have subsided considerably in 2013, however sovereign debt difficulties remain. Major concerns could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is therefore possible that over the next few years, levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. This could mean that sovereign debt concerns have not disappeared but merely postponed.

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 at all times 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 to cover cashflow needs, or to extend the period to one year or more with selected government-backed counterparties.

During the October to December 2013 period, significant use has been made of call account facilities paying around 0.60%, 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 remains low, it is still well in excess of overnight treasury deposit rates.

The Treasury Activity Report for the quarter ended 31 December 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 1.20% has been achieved for the period to 31 December 2013, which outperforms both the 7 day and 3 month LIBID rates of 0.36% and 0.39% by 0.84% and 0.81% respectively. This has been achieved as a result of prudent investments made in 2012/13 however rates in the market currently remain extremely poor, and as the loans with favourable rates mature, it is increasingly difficult to replace them. Members are advised that the equated rate is likely to drop a little further over the remaining quarter of the year as further fixed rate loans mature, since security and liquidity will always remain the overriding factors in the Council's treasury management. The outturn position for investment interest is expected to be broadly in line with the current approved estimate.

Credit ratings advice continues to be taken from CASTS, 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 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 differ to the actual borrowing planned in the year.

In view of borrowing previously undertaken in advance of need, it is not

currently anticipated that any 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 CASTS 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 CASTS.

No debt rescheduling has been undertaken during the period from 1 April 2013 to 31 December 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 31 December 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 £4,066,400. 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 including slippage of

schemes to 2014/15.

ii) Capital Financing Requirement (CFR)

The projected closing CFR for 2013/14 is £13,135,400. 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 31 December was £10.812m which was well within the approved indicator.

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 31 December 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.

Appendices

1. Treasury Activity Report 2013/14 for quarter ended 31 December 2013.
2. Definitions of LIBOR and LIBID
3. Prudential and Treasury Indicators as at 31 December 2013.

Background Papers

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

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

For more information, please contact:

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