Report to Cabinet

Subject: Prudential Code Indicator Monitoring 2014/15 and Quarterly Treasury Activity Report for Quarter ended 30 June 2014

Date: 7 August 2014

Author: Corporate Director (Chief Financial Officer)

Wards Affected

All

Purpose

To inform members of the performance monitoring of the 2014/15 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 2014/15 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 June and highlights compliance with the Council's policies.

Proposal

2.1 Economic update

UK growth was strong in quarters 2, 3 and 4 of 2013 as well as Q1 of 2014, at 0.7%, 0.8%, 0.7% and 0.8% respectively. Encouraging forward surveys indicate that strong growth will continue. There are also positive indications that the 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 through the threshold of 7%, set by the Monetary Policy Committee (MPC) last August for consideration of any increase in bank rate. The MPC has now broadened its forward guidance by adopting five qualitative principles, and looking at a much wider range of indicators in order to form a view on how much capacity there is in the economy, and how quickly that capacity is being used up. Accordingly, markets are expecting a first increase around the end of 2014.

There has been a sharp fall in inflation (CPI), which reached 1.5% in May, the lowest rate since 2009. The return to strong growth has also helped to lower forecasts for the increase in government debt by £73bn over the next five years as announced in the Autumn Statement, and by an additional £24bn announced in the March Budget, which also forecast a return to a significant budget surplus of £5bn in 2018/19. Monthly public sector deficit figures have however been disappointing during Q1 of 2014.

In June, the Federal Reserve in the USA continued with its monthly $10bn reduction in asset purchase, which has now fallen from $85bn per month to $35bn and are expected to stop by Q3, providing that strong economic growth continues this year. First quarter GDP figures were depressed by exceptionally bad winter weather, however growth rates since appear to be recovering well.

The Eurozone (EZ) is facing an increasing threat from deflation, with the average rate of inflation for all EZ countries falling in May to 0.5%. This masks however that some countries already have negative rates of inflation. Accordingly, the European Central Bank (ECB) took some limited action in June to loosen monetary policy in order to promote growth.

2.2 Interest rate forecasts

The Council's treasury advisor, Capita Asset Services Treasury Solutions

(CASTS) undertook a review of its interest rate forecasts in May, after the Bank of England's latest quarterly Inflation Report. However, more recent developments to the Bank of England's forward guidance have necessitated a second update and this was carried out on 30 June. The latest forecast now includes a first increase in bank rate in Q1 of 2015 – previously Q4 of 2015.

CASTS has provided the following forecast:

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.40%	4.40%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%
50yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded during 2013, and during the first quarter of 2014, to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys indicate that growth prospects are also strong for the rest of 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 does need 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 has been that wage inflation has been significantly below CPI inflation so disposable income and living standards have been eroded (although income tax cuts have ameliorated this to some extent). However, recent falls in inflation have created the potential for the narrowing of this gap and it could narrow further during 2014, especially if there is also a recovery in growth in labour productivity, leading to increases in pay rates.

The USA, the main world economy, faces similar debt problems to those of the UK but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual deficit has been halved from its peak without doing too much damage to growth, although labour force participation rates remain lower than ideal.

Concerns regarding the Eurozone subsided considerably during 2013, however sovereign debt difficulties remain and 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, potentially meaning that sovereign debt concerns have not disappeared but merely postponed.

2.3 Investment strategy

The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by Council on 3 March 2014.

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 cash flow needs, or to extend the period up to one year with selected government-backed counterparties.

During the April to June 2014 period, significant use has been made of call account facilities paying around 0.60%, and of a Money Market Fund achieving around 0.39%. 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 30 June 2014 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 0.80% has been achieved for the period to 30 June 2014 which, whilst very low, outperforms both the 7 day and 3 month LIBID rates of 0.34% and 0.41% by 0.46% and 0.39% respectively. This has been achieved as a result of the 2014/15 impact of prudent investments made in 2013/14. Rates in the market remain poor and as these loans mature it is challenging to replace them, since security and liquidity will always remain the overriding factors in the Council's treasury management. Interest rates are not expected to start rising until the final quarter of the year, and then not significantly. The outturn position for investment interest is currently expected to be broadly in line with the current approved estimate of £103,700.

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 30 June 2014.

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 2014/15.

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 2014 to 30 June 2014.

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 3 March 2014.

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 June 2014 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 2014/15, 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 £4,310,300. This differs to the original estimate of £2,902,100 due to the inclusion of approved carry-forward requests from 2013/14 and variations to the capital programme at Quarter 1.

ii) Capital Financing Requirement (CFR)

The projected closing CFR for 2014/15 is £12,441,200. This is lower than the approved indicator of £12,546,300 due to the above amendments to the capital programme and to additional capital receipts generated.

iii) Ratio of Financing Costs to Net Revenue Stream

The projected outturn of 6.43% shows a minor reduction from the approved indicator of 6.44%. This is due to a reduction in MRP as a result of slippage on the capital programme in 2013/14, largely offset by a revenue contribution to capital expenditure in 2014/15.

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 2014/15 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 June 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 2014/15 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 June 2014, 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 2014/15 for quarter ended 30 June 2014.
2. Definitions of LIBOR and LIBID
3. Prudential and Treasury Indicators as at 30 June 2014.

Background Papers

None identified.

Recommendation

That:

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