Gedling Borough Council

Report to Cabinet

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

Date: 8 August 2013

Author: Corporate Director (Chief Financial Officer)

Wards Affected

Not applicable

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 June and highlights compliance with the Council's policies.

Proposal

2.1 Economic Update

Recession was avoided in the first quarter of 2013, with a 0.3% quarterly expansion. On past evidence, business surveys for April and May indicate 0.5% quarterly growth in Q2. The service sector expanded by 0.8%, and while output in the construction sector in April was 1% lower than a year ago, it was the smallest annual fall since the end of 2011, suggesting that the sector supported the recovery in Q2.

There have been encouraging signs in household spending in Q2 of 2013, with May's 2.1% monthly rise in retail sales overturning April's 1.1% fall. Non high-street spending also looks to have been robust, with for example, new car registrations up by 20% in the year to May.

The pick-up in economic growth has supported the labour market, with employment rising by 24,000 in the three months to April. Meanwhile, pay growth rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the additional rate of income tax.

The Bank of England extended its Funding for Lending Scheme into 2015 and sharpened the incentives for banks to extend more business funding, however to date, the mortgage market still appears to have been the biggest beneficiary from the scheme. Alongside the Government's Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. This rise in demand has helped to push up house prices, with both the Halifax and Nationwide measures reporting a 0.4% monthly gain in May

The 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plans. Total expenditure was still forecast to be broadly flat in real terms in 2015/16 and the £50bn planned capital expenditure announced for that fiscal year was identical to the amount already outlined in March's Budget.

June's MPC meeting was the last chaired by the outgoing Governor Mervyn King, ahead of the arrival of Mark Carney. The Committee voted 6-3 to keep the level of asset purchases (quantitative easing) unchanged at £375bn, with the majority judging that the current stimulus and Funding for Lending Scheme would be sufficient to support growth in the context of price stability.

CPI inflation rose to 2.7% in May, having fallen from 2.8% to 2.4% in April. This mostly reflected price changes due to the earlier timing of Easter, which depressed inflation in April. Inflation is likely to have risen further in June with last year's fuel price falls providing an unfavourable annual comparison. However, underlying price pressures seem to be easing, with wages and producer prices both growing at subdued rates.

In the US, the statement from the Federal Reserve sparked a sharp sell-off in the Treasury market. The Fed move was a response to the improving economic outlook in the US, with payroll figures showing that the US added 175,000 new jobs in May, helping to pull the unemployment rate down to 7.6%, from 8.2% a year ago. In the housing market, house prices rose by 12% in the year to April, which helped to bring more households out of negative equity.

Meanwhile, tensions in the Eurozone eased but there remained a number of triggers for a potential flare-up. For example, the Democratic Left party left the Greek governing coalition in June, causing 10 year Greek government bond yields to surge to 11.5% from around 8% a month ago. And while the economic survey data improved consistently over the first half of the year, data from the Eurozone is still pointing to a further contraction in output in Q2 of 2013. If this materialises, it would be the seventh quarter of Eurozone recession, the longest on record

2.2 Interest Rate Forecasts

Sector undertook a review of its interest rate forecasts following the issue of the latest Bank of England Inflation Report in May 2013. The forecast for a first increase in Bank Rate in March 2015 was left unchanged, however, forecasts for PWLB rates have been increased as a result of the marked recovery in confidence in equity markets, anticipating stronger economic recovery in America, supported by growth in the Far East. The rise in equity prices slowed towards the end of the quarter on comments from Ben Bernanke, chairman of the Federal Reserve, that QE could be tapered off in the not too distant future. This caught the financial markets by surprise and generated a movement out of bonds and equities, and the sharp selloff in bonds caused ten year bond yields to jump up nearly 90 bps between the low and high for the quarter.

The Council's treasury advisor, Sector, has provided the following forecast:

	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%	0.75%
5yr PWLB rate	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%
10yr PWLB rate	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%
25yr PWLB rate	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%
50yr PWLB rate	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70%

Mark Carney started his tenure as the new Governor of the Bank of England on 1 July. His appointment could lead to some changes to the way the MPC operates and makes decisions and announcements. It is possible there could be "forward guidance", eg. that Bank Rate will not go up until some target rate, perhaps unemployment, had fallen to a specified level. Some commentators predict that this could effectively delay any increase in Bank Rate until sometime during 2016.

Economic forecasting remains problematic with so many external influences weighing on the UK. Major volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow. Key areas of uncertainty include:

- The potential for a significant negative reactions in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.

- The Italian political situation is frail and unstable.

- Problems in other Eurozone heavily indebted countries could also generate safe haven flows into UK gilts.

- Monetary policy action failing to stimulate growth in western economies, especially the Eurozone and Japan.

- The potential for weak growth or recession in the UK's main trading partners - the EU and US.

- The impact of the UK Government's austerity plan in dampening confidence and growth.

- Geopolitical risks e.g. Syria, Iran, North Korea

However, there is particular potential for upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates, as follows:

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

- A renewed increase in investor confidence that robust world economic growth is firmly expected, together with a reduction or end of QE operations in the US, causing a flow of funds out of bonds into equities.

- A reversal of Sterling's safe-haven status on an improvement in financial stresses in the Eurozone.

- In the longer term, a reversal of QE - this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.

- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt, consequent upon repeated failure to achieve fiscal correction targets and recovery of economic growth.

The overall balance of risks to economic recovery in the UK is now evenly weighted. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Near-term, the prospect of further QE has diminished but measures other than QE may be more favoured by Governor Carney if additional support is viewed as being required.

Given the generally weak outlook for economic growth, Sector sees the prospects for any increase in Bank Rate before 2015 as limited, indeed the first increase could be even further delayed if the tentative signs of growth failed to be maintained.

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 April to June 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 not spectacular, it is well in excess of overnight treasury deposit rates.

The Treasury Activity Report for the quarter ended 30 June 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 1.73% has been achieved for the period to 30 June 2013, which outperforms both the 7 day and 3 month LIBID rates of 0.39% and 0.56% by 1.34% and 1.17% respectively. However, rates in the market remain very poor, and as loans with very favourable rates mature it is becoming increasingly difficult to replace them. Accordingly, the equated rate is expected to drop sharply over the remainder of the year, since security and liquidity will remain the overriding factors in the Council's treasury management. This fall was anticipated in the preparation of the budget for 2013/14, and interest earned remains broadly in line with expectations at this early stage.

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 30 June 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.

The latest projection of the requirement for borrowing in 2013/14 is £3,246,000, however in view of borrowing previously undertaken in advance of need it is not currently anticipated that all of this will be undertaken during the current year.

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 Sector with regard to the amount and timing of any additional borrowing, and should conditions be 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 Sector.

No debt rescheduling was undertaken during the three months to 30 June 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 June 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 £5,098,100. 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 currently proposed for 2013/14. These are mainly the deletion of the budget for office accommodation joint working, offset by additional investment in Arnold Leisure Centre and Civic Centre alterations.

ii) Capital Financing Requirement (CFR)

The projected closing CFR for 2013/14 is £14,187,800. This is lower than the approved indicator of £14,440,200 due to the above amendments to the capital programme.

iii) Ratio of Financing Costs to Net Revenue Stream

The projected outturn of 5.84% shows a reduction from the approved indicator of 6.37%. This is 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 June 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 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) 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 June 2013, 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 2013/14 for Quarter ended 30 June 2013.
Appendix 2 - Definitions of LIBOR and LIBID
Appendix 3 - The Prudential and Treasury Indicators as at 30 June 2013.

Background Papers

6. 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

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

APPENDIX 1

Treasury Activity Report 2013/14

For the quarter ended 30 June 2013

	Position @ 1 April 2013	Loans Made during Q1	Loans Repaid during Q1	Position @ 30 June 2013
	£	£	£	£
Long Term Borrowing				
PWLB	**10,811,577**	**0**	**0**	**10,811,577**
Temporary Borrowing				
Local Authorities	600,000	1,000,000	(1,600,000)	0
Central Government	0	0	0	0
Banks and other Institutions	0	0	0	0
Total Temporary Borrowing	**600,000**	**1,000,000**	**(1,600,000)**	**0**
TOTAL BORROWING	**11,411,577**	**1,000,000**	**(1,600,000)**	**10,811,577**
Temporary Investment				
Bank of Scotland	(8,000,000)	(0)	1,000,000	(7,000,000)
Barclays	(0)	(0)	0	0
HSBC Treasury	(0)	(1,290,000)	1,290,000	0
Ignis Money Market Fund	(0)	(6,580,000)	6,580,000	0
Royal Bank of Scotland	(260,000)	(19,860,000)	12,730,000	(7,390,000)
Santander	(0)	(0)	0	0
Total Banks	**(8,260,000)**	**(27,730,000)**	**21,600,000**	**(14,390,000)**
Building Societies	(0)	0	0	0
Debt Management Office	(0)	0	0	0
Local Authorities and Others	(0)	0	0	0
TOTAL INVESTMENT	**(8,260,000)**	**(27,730,000)**	**21,600,000**	**(14,390,000)**
NET BORROWING / (INVESTMENT)	**3,151,577**	**(26,730,000)**	**20,000,000**	**(3,578,423)**

Investment				
Fixed Rate	(8,000,000)	(1,290,000)	2,290,000	(7,000,000)
Variable Rate	(260,000)	(26,440,000)	19,310,000	(7,390,000)
TOTAL INVESTMENT	**(8,260,000)**	**(27,730,000)**	**21,600,000)**	**(14,390,000)**

Temporary Investment and Borrowing Statistics at 30 June 2013:

Proportion of Fixed Rate Investment	48.645%
Proportion of Variable Rate investment	51.36%
Temporary Investment Interest Receivable	£48,537
Equated Temporary Investment	£2,803,565
Weighted Average Interest Rate Received	1.73%
7 Day LIBID (Benchmark) 28 June 2013	0.39%
3 Month LIBID 28 June 2013	0.56%

Borrowing

Temporary Borrowing Interest Payable	£58
Equated Temporary Borrowing	£20,822
Weighted Average Interest Rate Paid	0.28%
7 Day LIBOR (Benchmark) 28 June 2013	0.52%

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 2013-14

Prudential Indicators:		2013-14 Approved Indicator	Projected Outturn at 30 June 2013
a)	Capital Expenditure	£4,396,700	5,098,100
b)	Capital Financing Requirement (CFR)	£14,440,200	£14,187,800
c)	Ratio of Financ'g Costs to Net Revenue Stream	6.37%	5.84%
d)	Incremental impact of new 2012/13 capital investment decisions	£5.65	Not Applicable
e)	Maximum Gross Debt	£15,524,500	£10,811.577

Treasury Management Indicators:		2013-14 Approved Indicator	Actual Position at 30 June 2013
a)	Operational Boundary for External Debt:		
	Borrowing	£16,500,000	£10,811,577
	Other Long Term Liabilities	£1,500,000	-
	Total Operational Boundary	**£18,000,000**	**£10,811,577**
b)	Authorised Limit for External Debt:		
	Borrowing	£17,500,000	£10,811,577
	Other Long Term Liabilities	£1,500,000	-
	Total Authorised Limit	**£19,000,000**	**£10,811,577**
c)	Upper limit for fixed interest exposure (Max o/s net Borrowing)	£15,500,000	£3,811,577
	Local indicator-Investment only	100%	48.64%
	Local indicator-Borrowing only	100%	100.00%
d)	Upper limit for variable interest exposure (Max o/s net Borrowing)	£2,000,000	(£260,000) Nb. net investment
	Local indicator-Investment only	100%	51.36%
	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%	0.00%
	1-2 years	35%	9.25%
	2-5 years	50%	27.75%
	5-10 years	50%	0.00%
	Over 10 years	100%	63.00%
f)	Investment Treasury Indicator and limit		
	Maximum NEW principal sums invested for periods over 364 days, during 2013/14 (new non-specified investments)	£3,000,000	£0
	TOTAL non-specified Limit per TMSS	£5,000,000	£2,000,000