Cheltenham Borough Council
Cabinet – 10 December 2013
Council – 16 December 2013
Treasury Mid-Term Report 2013/14

Accountable member	**Finance & Community Development , John Rawson**
Accountable officer	**Director Resources , Mark Sheldon**
Accountable scrutiny committee	**Overview and Scrutiny**
Ward(s) affected	**None**
Key Decision	**Yes**
Executive summary	The Treasury Management Strategy for 2013/14 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 (revised 2011), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority has adopted the code and complies with its requirements.
Consultation	The Treasury Management Panel considered this report on 27th November 2013.
Recommendations	**Council approve the following recommendation :** **1. Note the contents of the summary report of the treasury management activity during the first six months of 2013/14.**

Financial implications	All financial implications are detailed throughout the report **Contact officer: Andrew Sherbourne, andrew.sherbourne@cheltenham.gov.uk, 01242 264337**
Legal implications	None specific arising from the report recommendations. **Contact officer: Peter Lewis, peter.lewis@tewkesbury.gov.uk, 01242 264216**
HR implications (including learning and organisational development)	No direct HR implications arising from this report **Contact officer: Julie McCarthy, Julie.McCarthy@cheltenham.gov.uk. 01242 264355**
Key risks	see appendix 2

Corporate and community plan Implications	None
Environmental and climate change implications	None

1. Background

1.1 The Treasury Management Strategy for 2013/14 has been developed by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 (revised 2011), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority has adopted the code and complies with its requirements, one of which is the provision of a Mid-year report to Members.

2. Economic update for the first six months

2.1 The following key points have been provided by the councils Treasury Advisors, Capita Asset Services.

2.2 During 2013/14 economic indicators suggested that the economy is recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion the economy grew 0.7% in Q2. There have been signs of renewed vigour in household spending in the summer, with a further pick-up in retail sales, mortgages, house prices and new car registrations.

2.3 The strengthening in economic growth appears to have supported the labour market, with employment rising at a modest pace and strong enough to reduce the level of unemployment further. Pay growth also rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.0% y/y, well below the rate of inflation at 2.7% in August, causing continuing pressure on household's disposable income.

2.4 The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling further to new lows. Together with 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. Mortgage approvals by high street banks have risen as have house prices, although they are still well down from the boom years pre 2008.

2.5 Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 started to come down, but only slowly, as Government expenditure cuts took effect and economic growth started to show through in a small increase in tax receipts. 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 new Bank of England Governor, Mark Carney, arriving. Bank Rate remained at 0.5% and quantitative easing also stayed at £375bn. In August, the MPC provided forward guidance that Bank Rate is unlikely to change until unemployment first falls to 7%, which was not expected until mid 2016. However, 7% is only a point at which the MPC will review Bank Rate, not necessarily take action to change it. The three month to July average rate was 7.7%. CPI inflation (MPC target of 2.0%), fell marginally from a peak of 2.9% in June to 2.7% in August. The Bank of England expects inflation to fall back to 2.0% in 2015.

3. Portfolio position 1/4/2013 to 30/9/2013

Movements in the Council's borrowing during the first six months of 2013/14 financial year can be seen in the table below. Long term loans are deemed to be those repayable over a period of more than one year.

Source of Loan Temporary Borrowing	Balance at 1 April 2013 £	Raised during Apr-Sept £	Repaid during Apr-Sept £	Balance at 30 Sept 2013 £
- Local Authorities	2,000,000	4,100,000	6,100,000	0
Temporary Investment	20,000	0	0	20,000
Total Short Term Borrowing	**2,020,000**	**4,100,000**	**6,100,000**	**20,000**
Long Term Borrowing				
- Public Works Loan Board	40,778,000	1,200,000	82,140	41,895,860
- Market Loans	15,900,000	0	0	15,900,000
Long Term Borrowing	**56,678,000**	**1,200,000**	**82,140**	**57,795,860**
Total External Borrowing	**58,698,000**	**5,300,000**	**6,182,140**	**57,815,860**

3.1 In February 2013 the Council's borrowing costs for 2013/14 was set to be £2,019,300. This is now forecast to come under by approximately £6,000 against budget. Average temporary borrowing of £430k at an average interest rate of 0.29% has occurred between 1st April and 30th September 2013 to meet temporary cash flow shortfalls against a forecasted rate of 0.32% on an average temporary borrowing balance of £1.3m. Of the £57.8m borrowing outstanding as at 30th September 2013, the HRA share of this is £44.7m, leaving the General Fund with £13.1m.

3.2 The PWLB remains an attractive source of borrowing for the Council as it offers flexibility and control. Due to downward moves in gilt yields in the first quarter, this resulted in PWLB rates falling across all maturities. In May 2013 a loan of £1.2m was taken out with the PWLB for ten years at a rate of 1.80% on behalf of Gloucestershire Airport Ltd. The loan is cost neutral for the Council as the Airport are repaying the Council in line with the repayment schedule.

4. Investments

The DCLG's Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy for 2012/13 approved by Council on the 8th February 2013. This restricted new investments to the following

- T-Bills and the Debt Management Office (DMO)
- Other Local Authorities
- AAA-rated Money Market Funds
- UK Banks & Building Societies – Minimum long term rating of A or equivalent across all three rating agencies (Fitch, Standard & Poors and Moody's)
- Other - Cheltenham Festivals, Gloucestershire Airport Company, Everyman Theatre, Ubico and Cheltenham Borough Homes

Counterparty credit quality is assessed and monitored with reference to :-

- Credit ratings
- Credit Default Swaps
- Share Price
- GDP of the country in which the institution operates

4.1 It is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.50% Bank Rate. Indeed, the introduction of the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. As agreed as part of the 2013/14 Treasury Management Strategy investments were only to be made to UK based banks/building society which met the lending criteria set, and up to a maximum period of one year. Treasury officers have kept to this strategy for the period reported on. Given this risk environment, investment returns are likely to remain low.

4.2 **Investments -** Movements in the Council's investment portfolio during the first six months of 2013/14 can be seen in the table below.

Source of Loan Short term Lending	Balance at 1 April 2013 £	Raised during Apr-Sept £	Repaid during Apr-Sept £	Balance at 30 Sept 2013 £

Bank – Term Deposit	0	5,000,000	4,000,0000	1,000,000
Bank of Scotland Call A/C	3,830,000	48,801,000	50,711,000	1,920,000
Santander Uk Call A/C	0	17,930,000	15,180,000	2,750,000
Glos Airport Ltd	350,000	0	35,000	315,000
Total Short Term Lending	**4,180,000**	**71,731,000**	**69,926,000**	**5,985,000**
Icelandic Banks in administration	**Balance at 1 April 2013 £**	**Raised during Apr-Sept £**	**Repaid during the year £**	**Balance at 30 Sept 2013 £**
- Kaupthing Singer & Friedlander	720,000	0	90,000	630,000
- Glitnir	572,400	0	0	572,400
- Landsbanki	2,550,000	0	126,480	2,423,520
Total Icelandic Banks	**3,842,400**	**0**	**216,480**	**3,625,920**
Total External Investments	**8,022,400**	**71,731,000**	**70,142,480**	**9,610,920**

4.3 In February 2013 the Council's Investment income for 2013/14 was budgeted to be £24,400. The average cash balances representing the council's reserves and working balances, was £7.5m during the period this report covers. The Council anticipates an investment outturn of £37,600 at a rate of 0.64% for the whole year. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14.

4.4 Included within the investments of £9.61m as at 30th September 2013, the Council has £3.626m deposited in the collapsed Icelandic banks.

4.5 Glitnir's Winding – up - Board made a distribution to priority creditors back in March 2012, which amounted to 78p in the pound. The remaining balance is held in an escrow account in Iceland. The Central Bank of Iceland is controlling the movement of Icelandic Krona's, so the Council has been unable to gain access to these funds. The Council is working with the Local Government Association (LGA) and Bevan Brittan (appointed solicitors) to recover the remaining amount. 100% is expected to be recovered

4.6 Landsbanki Winding – up - Board made a fourth distribution over the 12th & 13th of September 2013 which takes the repayments made to just under 55p in the pound. Further distributions are expected in the near future. 100% is expected to be recovered.

4.7 Kaupthing Singer & Friedlander administrators have made distributions of 79p in the pound to date. Administrators currently estimate a total return of 85p-86.5p in the pound.

5. Prudential Indicators

5.1 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Annual Treasury Strategy Statement. Appendix 1 attached highlights the major indicators.

6. Outlook

6.1 Economic forecasting remains difficult with so many external influences weighing on the UK. Volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities and safer bonds. The overall balance of risks to economic recovery in the UK is now weighted to the upside after five months of robust good news on the economy. However, only time will tell just how long this period of strong economic growth will last, and it remains exposed to vulnerabilities in a number of key areas.

6.2 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 very 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. They therefore expect the first increase in Bank Rate to be in quarter 4 of 2014. There is much leeway to disagree with this view as the economic downturn since 2008 was remarkable for the way in which unemployment did not rise to anywhere near the extent likely, unlike in previous recessions. This meant that labour was retained, productivity fell and now, as the MPC expects, there is major potential for unemployment to fall only slowly as existing labour levels are worked more intensively and productivity rises back up again. The size of the work force is also expected to increase relatively rapidly and there are many currently self employed or part time employed workers who are seeking full time employment. Capita Asset Services take the view that the unemployment rate is not likely to come down as quickly as the financial markets are currently expecting and that the MPC view is more realistic. The prospects for any increase in Bank Rate before 2016 are therefore seen as being limited. However, some forecasters are forecasting that even the Bank of England forecast is too optimistic as to when the 7% level will be reached and so do not expect the first increase in Bank Rate until spring 2017.

	Sep-13	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%	0.50%	0.75%	1.00%	1.25%
5yr PWLB rate	2.50%	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%	3.70%	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%	4.40%	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	4.50%	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%

7. Performance management

7.1 In compliance with the requirements of the Treasury Management CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first six months of 2013/14. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

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Appendices	Prudential Indicators Appendix 1 Risk Appendix 2
Background information	Treasury Management Strategy, Council 8th February 2013