Cheltenham Borough Council
Cabinet – 9th December 2014
Council – 15th December 2014
Treasury Mid-Term Report 2014/15

Accountable member	**Finance, 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 2014/15 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. An amendment to the 2014/15 Treasury Management Strategy is required in relation to sovereign support for the current approved lending list. The main rating agencies (Fitch, Moody's and Standard and Poor's) may remove some of the institutions' sovereign support following evolving regulatory changes. This process may commence during this financial year. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required. As a result of these rating agency changes, the credit element of Capita's future methodology will focus solely on the Short and Long Term ratings of each institution. Furthermore, Capita will continue to utilise Credit Default Swaps (CDS) prices as an overlay to ratings in their new methodology.
Consultation	The Treasury Management Panel considered this report on 17th November 2014.
Recommendations	**Cabinet approve the following recommendation to Council:** **1. Note the contents of the summary report of the treasury management activity during the first six months of 2014/15.** **2. Approve the changes to the credit methodology whereby viability, financial strength and support ratings will not be considered as key criteria in the choice of creditworthy investment counterparties.**

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 2014/15 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 Council's Treasury Advisors, Capita Treasury Solutions.

2.2 After strong UK GDP quarterly growth in the last three quarters of 2013 and quarters one and two of 2014, it appears very likely that strong growth will continue throughout the remaining part of 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering.

2.3 The strengthening in economic growth appears to have supported the labour market with unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) in August 2013, before it said it would consider any increases in the Bank Rate. The MPC has therefore subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range, of at least eighteen indicators in order to form a view on how much slack there is in the economy and how quickly it is being used up.

2.4 Also encouraging has been the sharp fall in inflation (CPI) reaching 1.2% in September, the lowest for five years and it is possible it could go as low as 1% later on this year. Overall markets are expecting that the MPC will be cautious in raising Bank Rate but a first increase is expected in Quarter 2 of 2015 and they expect rates to increase at a slow pace to lower levels than prevailed before 2008 as increases will have a much bigger effect on heavily indebted consumers than they did before 2008.

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 2014 £**	**Raised during Apr-Sept £**	**Repaid during Apr-Sept £**	**Balance at 30 Sept 2014 £**
- Local Authorities	0	4,200,000	4,200,000	0
Temporary Investment	20,000	0	0	20,000
Total Short Term Borrowing	**20,000**	**4,200,000**	**4,200,000**	**20,000**
Long Term Borrowing				
- Public Works Loan Board	41,808,880	1,400,000	178,156	43,030,724
- Market Loans	15,900,000	0	0	15,900,000
Long Term Borrowing	**57,708,880**	**1,400,000**	**178,156**	**58,930,724**
Total External Borrowing	**57,728,880**	**5,600,000**	**4,378,156**	**58,950,724**

3.1 In February 2014 the Council's borrowing costs for 2014/15 was set to be £2,014,300. This is now forecast to come under by approximately £2,500 against budget. Average temporary borrowing of £148k at an average interest rate of 0.33% has occurred between 1st April and 30th September 2014. Of the £59.04m borrowing outstanding as at 30th September 2014, the HRA share of this is £44.7m, leaving the General Fund with £14.34m in which £6.7m are loans taken out for third parties which are cost neutral to the Council.

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 2014 a loan of £1.4m was taken out with the PWLB for forty years at a rate of 4.22% on behalf of Cheltenham Borough Homes. The loan is cost neutral for the Council as Cheltenham Borough Homes 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 2014/15 approved by Council on the 14th February 2014 and then again on 21st July 2014 when amendments were made to the lending list. 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 part of the 2014/15 Treasury Management Strategy investments have only been 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 2014/15 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	3,000,000	11,000,000	4,000,000	10,000,000
Building Societies	2,000,000	13,600,000	8,800,000	6,800,000
Bank of Scotland Call A/C	5,315,000	47,025,000	50,580,000	1,760,000
Santander Uk Call A/C	5,645,000	12,255,000	17,900,000	0
Glos Airport Ltd	280,000	0	35,000	245,000
Money Market Funds	830,000	4,760,000	5,090,000	500,000
Total Short Term Lending	**17,070,000**	**88,640,000**	**86,405,000**	**19,305,000**
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	553,205	0	0	553,205
- Glitnir	572,400	0	0	572,400
Total Icelandic Banks	**1,125,605**	**0**	**0**	**1,125,605**
Total External Investments	**18,195,605**	**88,640,000**	**86,405,000**	**20,430,605**

4.3 In February 2014 the Council's Investment income for 2014/15 was budgeted to be £41,400. The average cash balances representing the council's reserves and working balances, was £17.2m during the period this report covers. The Council anticipates an investment outturn of £111,400 at a rate of 0.63% 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 2014/15.

4.4 Included within the investments of £20.43m as at 30th September 2014, the Council has £1.126m 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 Kaupthing Singer & Friedlander administrators have made distributions of 81.5p in the pound to date. Administrators currently estimate a total return of 85p-86.5p in the pound. The next dividend is expected to be paid out in early December 2014 and is estimated to be a 1p 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 Capita Asset Services undertook a review of its interest rates in mid - August and then again in October 2014. The latest forecast includes a first increase in Bank Rate in quarter 2 of 2015. Downside risks to rates rising would be that the UK strong economic growth is currently dependent on consumer spending and the unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014. Also a weak rebalancing of UK growth to exporting and business investment causing a weakening of overall growth beyond 2014 as well as a return to weak growth in the US and China, UK's two main trading partners could suspend any future Bank Rate rises.

	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%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%
5yr PWLB rate	2.70%	2.50%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%
10yr PWLB rate	3.40%	3.20%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%
25yr PWLB rate	4.00%	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%
50yr PWLB rate	4.00%	3.90%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%

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 2014/15. 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	Risk Appendix 1 Prudential Indicators Appendix 2
Background information	Treasury Management Strategy, Council 8th February 2014