

Cheltenham Borough Council
Cabinet – 11th December 2012
Council – 17th December 2012
Treasury Mid-Term Report 2012/13

Accountable member	Cabinet Member Finance, Councillor John Rawson
Accountable officer	Director Resources , Mark Sheldon
Ward(s) affected	None
Key Decision	Yes
Executive summary	The Treasury Management Strategy for 2012/13 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, 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 19th November 2012.
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 2012/13.

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: Amanda Attfield, amanda.attfield@cheltenham.gov.uk. 07920 284313
Key risks	see appendix 1

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

1. Background

- 1.1** The Treasury Management Strategy for 2012/13 has been developed by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, 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, Arlingclose Ltd.
- 2.2** The world economy faced yet another turbulent six months. The UK and the Eurozone (except Germany) struggled to show visible growth whilst the US economy grew slowly. UK Growth Domestic Product (GDP) contracted by 0.3% on the first calendar quarter of 2012 and by 0.40% in the second, reflecting the difficult economic conditions faced by businesses and consumers domestically and globally.
- 2.2** Inflation which had remained stubbornly high throughout 2011 slowly began to fall. Annual CPI dipped below 3% for the first time in two and a half years in May and fell to the lowest level since November 2009 in June, with a rate of 2.4%. It moved up marginally to 2.5% by August. Although the recent rise in commodity prices has been worrying the rise in oil and food prices are well below the levels of 2010/11.
- 2.3** Some barometers of economic activity provided a more buoyant and positive picture but tendered to get overshadowed. Employment rose by 236,000 in the three months to July and the employment rate was at its highest since the three months to April 2009. The unemployment rate fell to 8.1% on the last quarter, the underlying data pointing to a more resilient and optimistic outlook for the economy
- 2.4** The lack of growth and the fall in inflation were persuasive enough for the Bank of England to sanction £50 billion of Quantative Easing (QE) in July, taking QE to £375 billion. The possibility of a rate cut from the current level of 0.5% was discussed at MPC meetings in June and July but was subsequently dropped suggesting that this policy option has been postponed for the immediate future. The government's Funding for Lending Scheme (FLS) initiative, intended to lower bank's funding costs, commenced in August. The Bank of England will assess its effects in easing the flow of credit before committing to further policy action.
- 2.5** The European sovereign debt crisis deepened. With the continuing problems in Greece, the Euro region suffered a renewed bout of stress when Italian and Spanish government borrowing costs rose sharply with Spain being forced to officially seek a bailout for its domestic banks. The European Central bank responded with the announcement in September of its Outright Monetary Transactions (OMT) facility which allows the ECB to buy unlimited amounts of one to three year sovereign bonds provided the sovereign(s) first asks for assistance and adheres to the strict

conditions attached to such purchases.

- 2.6 The economic uncertainty resulted in analysts postponing the likelihood of an increase in the UK Bank Rate until late 2014 at the earliest.

3. Portfolio position 1/4/2012 to 30/9/2012

Movements in the Council's borrowing during the first six months of 2012/13 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	Balance at 1 April 2012 £	Raised during Apr-Sept £	Repaid during Apr-Sept £	Balance at 30 Sept 2012 £
Temporary Borrowing				
- Public Works Loan Board	2,000,000	0	0	2,000,000
- Banks	0	0	0	0
- Local Authorities	5,100,000	13,500,000	18,600,000	0
Temporary Investment	3,000	0	0	3,000
Total Short Term Borrowing	7,103,000	13,500,000	18,600,000	2,003,000
Long Term Borrowing				
- Public Works Loan Board	38,806,331	0	15,904	38,790,427
- Market Loans	15,900,000	0	0	15,900,000
Long Term Borrowing	54,706,331	0	15,904	54,690,427
Total External Borrowing	61,809,331	0	18,615,904	56,693,427

- 3.1 In February 2012 the Council's borrowing costs for 2012/13 was estimated to be £1,202,000. This is now forecast to be £2,095,100. This big increase is due to the additional borrowing of £27.414m taken from the PWLB in March 2012 to fund the HRA in coming out of the subsidy system. The HRA will be paying 100% of the interest relating to these loans. Temporary borrowing of £13.5m at an average interest rate of 0.30% has occurred between 1st April and 30th September 2012 to meet temporary cash flow shortfalls against a forecasted rate of 0.40%. Borrowing costs are now forecast for 2012/13 to be under by £35,200 against the original budget. The revised 2012/13 budget will be amended accordingly.

- 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 second quarter, this resulted in PWLB rates

falling across all maturities. In August HM Treasury announced details of the “Certainty Rate” which will enable this council to access cheaper PWLB funding, with a 20 basis point reduction on the standard PWLB borrowing rate. This has been introduced to encourage local authorities to provide robust forecasts on borrowing plans. This rate is expected to be introduced in November 2012. This council has completed the pro-forma projecting the Council’s likely borrowing requirement over a three period and returned it to the CLG by the deadline of 17th September 2012.

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 10th February 2012. 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

In June Moody’s completed its review of banks with global capital market operations, downgrading the long-term ratings of all of them by between one to three notches. The banks on the Council’s lending list which were affected by the ratings downgrades were Barclays, HSBC and the Royal Bank of Scotland. Separately the agency also downgraded the ratings of Lloyds Bank, Bank of Scotland, National Westminster Bank and Santander UK plc. None of the long-term ratings of the banks on the Council’s lending list were downgraded to below the Council’s minimum A-/A3 credit rating threshold.

- 4.1** Following the decision to shorten deposit durations with investment counterparties on the 3rd May 2012, the Council has since extended duration (decision made on 30th July 2012). The move to extend duration was as a result of monitoring economic and political developments in the UK. The various risk metrics highlighted in paragraph 4 to assess the creditworthiness of financial institutions had shown continued signs of stabilisation, and in some cases, considerable improvement.

4.2 Investments - Movements in the Council's investment portfolio during the first six months of 2012/13 can be seen in the table below.

Source of Loan	Balance at 1 April 2012 £	Raised during Apr-Sept £	Repaid during Apr-Sept £	Balance at 30 Sept 2012 £
Short term Lending				
- Building Societies	0	0	0	0
- Banks	2,000,000	0	2,000,000	0
Bank of Scotland Call A/C	0	22,150,000	19,090,000	3,060,000
Santander UK Call A/C	2,600,000	27,450,000	28,400,000	1,650,000
Total Short Term Lending	4, 600,000	49,600,000	49,490,000	4,710,000
Icelandic Banks in administration	Balance at 1 April 2012 £	Raised during Apr-Sept £	Repaid during the year £	Balance at 30 Sept 2012 £
- Kaupthing Singer & Friedlander	1,110,000	0	300,000	810,000
- Glitnir	630,900	0	0	630,900
- Landsbanki	3,439,255	0	611,710	2,827,545
Total Icelandic Banks	5,180,155	0	911,710	4,268,445
Total External Investments	9,780,155	49,600,000	50,401,710	8,978,445

4.3 In February 2012 the Council's Investment income for 2012/13 was budgeted to be £48,200. The average cash balances representing the council's reserves and working balances, was £3.2m during the period this report covers. The UK Bank Rate has been maintained at 0.50% since March 2009 and is not expected to rise until late 2014 or beyond. The Council anticipates an investment outturn of £58,400 at a rate of 1.13% 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 2012/13.

4.4 The Council set up a Safe Custody account with King and Shaxton in September 2012. By opening a custody account with King and Shaxton, the Council now has the ability to use a number of approved investment instruments such as Treasury Bills.

- 4.5 Included within the investments of £8.727m as at 30th September 2012, the Council has £4.017m deposited in the collapsed Icelandic banks. On October 28th 2011 the Icelandic Supreme Court ruled that UK local authority deposits in the administrations of Glitnir and Landsbanki qualified as priority claims. This means that the values of local authorities' claims in the Icelandic administrations qualifying for priority settlement are now final and will, at the very least, be equal to the value of the original deposit plus interest accrued.
- 4.6 Glitnir's Winding Up Board made a distribution to priority creditors, which included local authorities. This was accepted by all UK local authorities and implemented on the 16th March 2012. 78p in the pound has been recovered to date with the remaining balance held in an escrow account in Iceland. 100% is expected to be recovered
- 4.7 Landsbanki Winding Up Board made a second distribution on the 29th May 2012 which takes the repayments made to 43p in the pound. Further distributions are expected in the near future. 100% is expected to be recovered.
- 4.8 Kaupthing Singer & Friedlander administrators have made distributions of 73p in the pound to date. It is now expected that 85.25p in the pound will be recovered overall.
- 4.9 Further distributions have been made since September 2012 which will be included in the next update report to council

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.

6. Outlook

- 6.1 At the time of writing this activity report in November 2012, economic growth remains elusive. Tight credit conditions and weak earnings growth are constraining consumer and corporate spending. The outlook is for official interest rates to remain low for an extended period, as shown below.

	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Official Bank Rate													
Upside risk	--	--	--	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

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 2012/13. 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
Background information	Treasury Management Strategy, Council 10 th February 2012