Report to	Cabinet	**Item**
	11 December 2013	
Report of	Chief finance officer	10
Subject	Treasury management strategy statement and annual investment strategy mid-year review 2013/14	

Purpose

This report sets out the Treasury Management performance for the first six months of the financial year to 30 September 2013

Recommendations

To:-

(1) note the report and the treasury activity; and,

(2) recommend approval of the revised prudential indicators

Corporate and service priorities

The report helps to meet the corporate priority “value for money services”

Financial implications

The report has no direct financial consequences however it does report on the performance of the council in managing its borrowing and investment resources

Ward/s All wards

Cabinet member Councillor Waters - deputy leader and resources

Contact officers

Caroline Ryba, chief finance officer	01223 699292
Philippa Dransfield, chief accountant	01603 212562

Background documents

None

Background

1. The council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

2. The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer term cash flow planning to ensure the council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet council risk or cost objectives.

3. As a consequence treasury management is defined as:

   "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

Introduction

4. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011 was adopted by this council on 22 March 2011

5. The primary requirements of the code are as follows:

   a) Creation and maintenance of a treasury management policy statement which sets out the policies and objectives of the council's treasury management activities.

   b) Creation and maintenance of treasury management practices which set out the manner in which the council will seek to achieve those policies and objectives.

   c) Receipt by the full council of an annual Treasury Management Strategy Statement (TMSS) - including the annual investment strategy and minimum revenue provision policy - for the year ahead, a mid-year review and an annual report (stewardship report) covering activities during the previous year.

   d) Delegation by the council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

6. This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

   a) An economic update (Section 3);

   b) A review of the council's investment portfolio (Section 4);

   c) A review of the council's borrowing strategy (Section 5);

   d) A review of debt rescheduling (Section 6);

   e) A review of the Treasury Management Strategy Statement and Annual Investment Strategy (Section 7);

   f) The council's capital position (prudential indicators), including a review of compliance with Treasury and Prudential Limits (Section 8);

Economic update

Economic performance to date

7. 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.

8. 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.

9. 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.

10. 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%.

11. 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.

12. Financial markets sold off sharply following comments from Ben Bernanke (the Fed chairman) in June that suggested the Fed. may 'taper' its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK. Equity prices fell initially too, as Fed. purchasing of bonds has served to underpin investor moves into equities out of low yielding bonds. However, as the market moves to realign its expectations, bond yields and equities are likely to rise further in expectation of a continuing economic recovery. Increases in payroll figures have shown further improvement, helping to pull the unemployment rate down from a high of 8.1% to 7.3%, and continuing house price rises have helped more households to escape from negative equity. In September, the Fed. surprised financial markets by not starting tapering as it felt the run of economic data in recent months had been too weak to warrant taking early action. Bond yields fell sharply as a result, though it still only remains a matter of time until tapering does start.

13. Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a renewed flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to growth in Q2, so ending six quarters of Eurozone recession.

Outlook for the next six months of 2013/14

14. 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. Downside risks to UK gilt yields and PWLB rates include:

    a) A return to weak economic growth in the US, UK and China causing major disappointment to investor and market expectations

    b) The potential for a significant increase in negative reactions of populaces 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.

    c) The Italian political situation is frail and unstable: the coalition government fell on 29 September.

    d) Problems in other Eurozone heavily indebted countries (e.g. Cyprus and Portugal) which could also generate safe haven flows into UK gilts.

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

f) Weak growth or recession in the UK's main trading partners - the EU and US, depressing economic recovery in the UK.

g) Geopolitical risks e.g. Syria, Iran, North Korea, which could trigger safe haven flows back into bonds

15. Upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

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

    b) Increased investor confidence that sustainable robust world economic growth is firmly expected, together with a reduction or end of QE operations in the US, causing a further flow of funds out of bonds into equities.

    c) A reversal of Sterling's safe-haven status on a sustainable improvement in financial stresses in the Eurozone.

    d) In the longer term - a reversal of QE in the UK; 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.

    e) 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 sustained recovery of economic growth, causing the ratio of total government debt to GDP to rise to levels that provoke major concern.

16. 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. 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, there is some residual risk of further QE if there is a dip in strong growth or if the MPC were to decide to take action to combat the market's expectations of an early first increase in bank rate. If the MPC does takes action to do more QE in order to reverse the rapid increase in market rates, especially in gilt yields and interest rates up to 10 years, such action could cause gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below. The tension in the US over passing a federal budget for the new financial year starting on 1 October and raising the debt ceiling in mid October could also see bond yields temporarily dip until agreement is reached between the opposing republican and democrat sides. Conversely, the eventual start of tapering by the Fed. will cause bond yields to rise.

Investment Strategy

17. The Treasury Management Strategy Statement (TMSS) for 2013/14, which includes the annual investment strategy, was approved by the council on 19 February 2013. It sets out the council's investment priorities as being:

a) Security of capital;

b) Liquidity; and

c) Yield

18. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

19. The council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in higher rates in periods up to 12 months, with highly credit rated financial institutions, using Capita Asset Services' suggested creditworthiness approach.

20. The council held £61.4m of investments as at 30 September 2013 (£49.6m at 31 March 2013), the average investments held for the six months to 30 September 2013 was £68.988m.[1]

21. The following table shows the movement in investments for the first six months of the year.

Investments £'000	**TMSS**	**Actual 31 March 2013**	**Movement**		**Actual 30 September 2013**
			Invested	**Matured**	
Long term					
Banks		12,500	-	-	12,500
Local authorities		3,000	-	-	3,000
Short term					
Banks		19,000	30,560	(21,560)	28,000
Building societies		6,000	14,700	(9,700)	11,000
Local authorities		3,000	-	(3,000)	-
Cash equivalents[2]					

[1] The increase in investment balances is due to capital receipts of £5.0m, LGSS costs not having been invoiced therefore not paid £3.2m and timing issues on the capital programme.
[2] Cash Equivalents are those monies that are invested for 3 months or less at inception

Banks		5,050	27,710	(25,860)	6,900
Building societies		1,050	157,286	(158,336)	-
Debt management office		-	10,100	(10,100)	-
Total	**45,000**	**49,600**	**240,356**	**(228,556)**	**61,400**

22. The council's investment return for the first six months of 2013/14 is £443,462 which is £143,462 above the amount budgeted for the period of £300,000.

23. The council is part of a benchmarking group across Norfolk, Suffolk & Cambridgeshire; the table in appendix 3 shows the performance of the council's investments compared to the other councils (whom have been made anonymous).

24. The chief financial officer confirms that all investment transactions undertaken during the first six months of 2013/14 were within the approved limits in the annual investment strategy.

25. The current investment counterparty criteria selection the TMSS is meeting the requirement of the treasury management function.

Borrowing strategy

26. The council's capital financing requirement (CFR) for 2013/14 is £237.864 The CFR denotes the council's underlying need to borrow for capital purposes. If the CFR is positive the council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The table below shows the council has borrowings of £225.920 and has utilised cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

27. Appendix 1 shows the movement in interest rates during the six months, across all maturity bands. Appendix 2 sets out predicted interest rates going forward. However, due to the overall financial position no new external borrowing was undertaken. No further borrowing is expected to be undertaken during the remainder of this financial year.

28. The council's debt position is shown in the following table:

Borrowing **£'000**	**TMSS**	**Actual 31 March and 30 September 2013**
Long term		
Public works loan board	218,917	218,917

Money market	5,000	5,000
3% Stock (perpetually irredeemable)	499	499
Corporate bonds and external mortgages	61	74
Finance leases	1,429	1,430
Total	**225,906**	**225,920**

Debt rescheduling

29. No debt rescheduling was undertaken during the first six months of 2013/14

Treasury management strategy statement and annual investment strategy update

30. The TMSS for 2013/14 was approved by this Council on 19 February 2013 There are no proposed policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Prudential indicator 2013/14 **£'000**	**Original per TMSS**	**Revised**
Authorised limit	265,830	264,428
Operational boundary	225,830	224,428
Capital financing requirement	235,438	237,864

31. The council's operational boundary relates to the level of external debt that is expected in the future. In the Council's case this is approximately £13.4m below the capital financing requirement, which is the underlying need to borrow for a capital purpose. The difference relates to internal borrowing, or the use of cash balances in lieu of borrowing. This is an operational policy to reduce the loss arising from borrowing and investing at a lower interest rate, saving approximately 3.5% - 3.75% in interest costs had the monies been borrowed. It has the added benefit of reducing investment counterparty risk. This position is being carefully monitored to ensure a low risk position is maintained in the future.

The council’s capital position (prudential indicators) including a review of compliance with treasury and prudential limits

32. This part of the report is structured to update:

    a) The council’s capital expenditure plans;

    b) How these plans are being financed;

    c) The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and

    d) Compliance with the limits in place for borrowing activity.

Prudential indicator for capital expenditure

33. This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the budget.

Capital expenditure by service £’000	2013/14 Original estimate	2013/14 Revised estimate
Non-HRA	8,767	7,072
HRA	33,266	36,449
Total	**42,033**	**43,521**

Changes to the financing of the capital programme

34. The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the council by way of the capital financing requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the minimum revenue provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital expenditure £'000	2013/14 Original estimate	2013/14 Revised estimate
Total spend	**42,033**	**43,521**
Financed by: Capital receipts Capital grants Capital reserves Revenue	 5,938 3,502 17,574 15,019	 7,634 3,502 17,574 14,811
Total financing	**42,033**	**43,521**
Borrowing need	**-**	**-**

Changes to the prudential indicators for the capital financing requirement, external debt and the operational boundary

35. The tables below show the CFR, which is the underlying external need to incur borrowing for a capital purpose, and the expected debt position over the period, termed the operational boundary.

Prudential indicator – capital financing requirement £'000	2013/14 Original estimate	2013/14 Revised estimate
CFR – non housing	21,081	26,305
CFR – housing	214,357	211,559
Total CFR	235,438	237,864
Net movement in CFR		**2,426**

Prudential indicator – external debt / the operational boundary £'000	2013/14 Original estimate	2013/14 Revised estimate
Borrowing	224,477	224,490
Other long term liabilities*	1,353	1,430
Total debt 31 March	**225,906**	**225,920**

** On balance sheet finance leases*

Limits to borrowing activity

36. The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose*. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

Borrowing limit £'000	2013/14 Original estimate	2013/14 Revised estimate
Gross borrowing	224,477	224,490
Plus other long term liabilities*	1,353	1,430
Less investments	40,000	60,000
Net borrowing	**185,830**	**165,920**
CFR* (year end position)	**235,438**	**237,864**

** Includes on balance sheet finance leases*

37. The chief finance officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

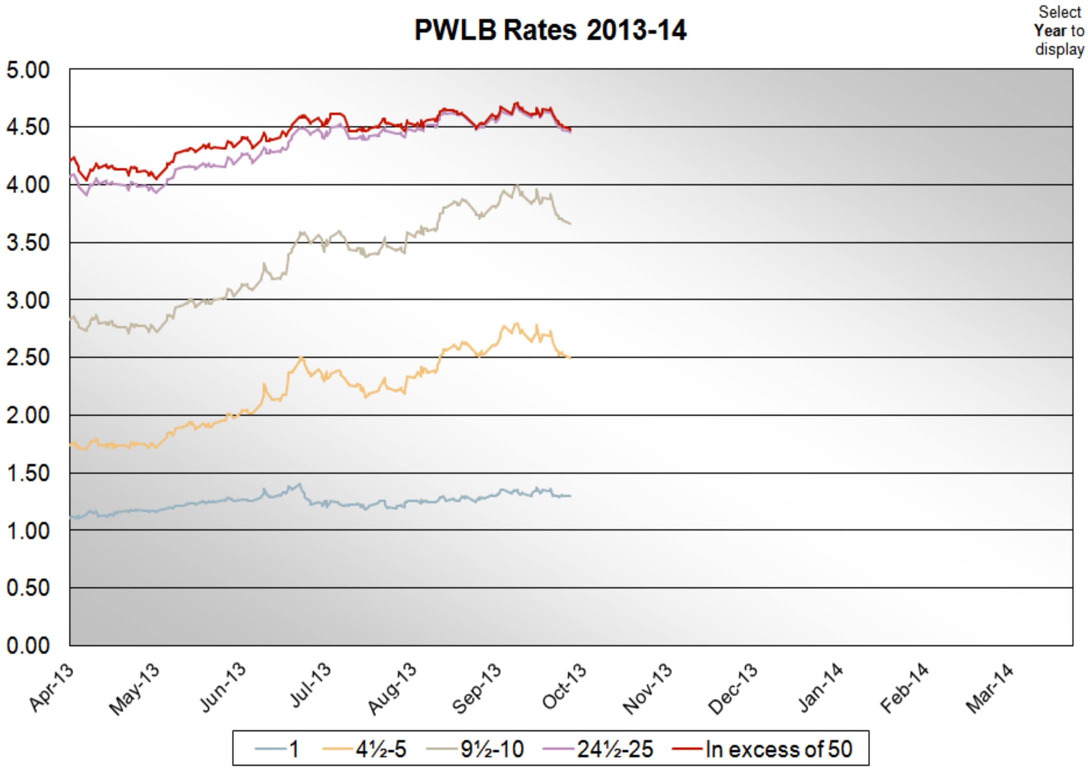
38. A further prudential indicator controls the overall level of borrowing. This is the authorised limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable

in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt **£'000**	**2013/14** **Original indicator**	**2013/14** **Revised indicator**
Borrowing	264,027	262.998
Other long term liabilities*	1,353	1,430
Total	**265,580**	**264,428**

** Includes on balance sheet finance leases*

<u>Movement in PWLB rates for the first six months of the year (to 30.9.13)</u>



APPENDIX 2

Treasury management adviser’s (sector’s) interest rate forecast

	PWLB borrowing rates 2013/14 for 1 to 50 years								
	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
2/4/13	1.120%	1.150%	1.350%	1.530%	1.750%	2.840%	4.080%	4.230%	1.470%
30/9/13	1.300%	1.420%	1.870%	2.190%	2.500%	3.660%	4.450%	4.480%	1.470%
High	1.390%	1.530%	2.060%	2.430%	2.780%	3.980%	4.670%	4.700%	1.480%
Low	1.110%	1.120%	1.250%	1.410%	1.610%	2.580%	3.780%	4.070%	1.450%
Average	1.252%	1.331%	1.669%	1.936%	2.213%	3.343%	4.337%	4.437%	1.464%
Spread	0.280%	0.410%	0.810%	1.020%	1.170%	1.400%	0.890%	0.630%	0.030%
High date	24/6/13	18/9/13	18/9/13	10/9/13	10/9/13	10/9/13	10/9/13	10/9/13	9/4/13
Low date	5/4/13	15/4/13	15/4/13	15/4/13	15/4/13	19/4/13	19/4/13	3/5/13	10/5/13

Benchmarked performance

APPENDIX 3

The table below shows that the rate of return being achieved by the council is highest of the benchmarking group and details average risk and longest time to maturity compared to the rest of the benchmarking group. The figures in brackets are those at 31 March 2013.

Council	WARoR	WA Risk	WAM	WA Tot. time
Norwich	1.23% (1.72%)	4.2 (3.9)	241 (293)	494.3 (566)
A	0.90% (1.45%)	3.3 (3.5)	90 (147)	209.3 (291)
B	0.68% (0.82%)	3.1 (3.4)	77 (103)	135.6 (137)
C	0.83% (1.92%)	4.2 (4.0)	121 (64)	227.3 (240)
D	1.06% (1.65%)	3.7 (3.6)	132 (164)	241.1 (270)
E	0.54% (0.51%)	4.1 (4.4)	90 (26)	144.8 (32)
F	0.66% (0.66%)	4.1 (3.3)	27 (0)	75.8 (0)

WARoR – Weighted average rate of return. This is the average annualised rate of return weighted by the principle amount in each rate

WA risk – Weighted average risk number. Each institution is assigned a colour to a suggested duration using Sector's credit methodology. The institution is assigned a number based on its colour and an average, weighted using principal amount, of these numbers is calculated.

1 Up to 5 years

2 Up to 2 years

3 Up to 1 year

4 Up to 6 months

5 Up to 3 months

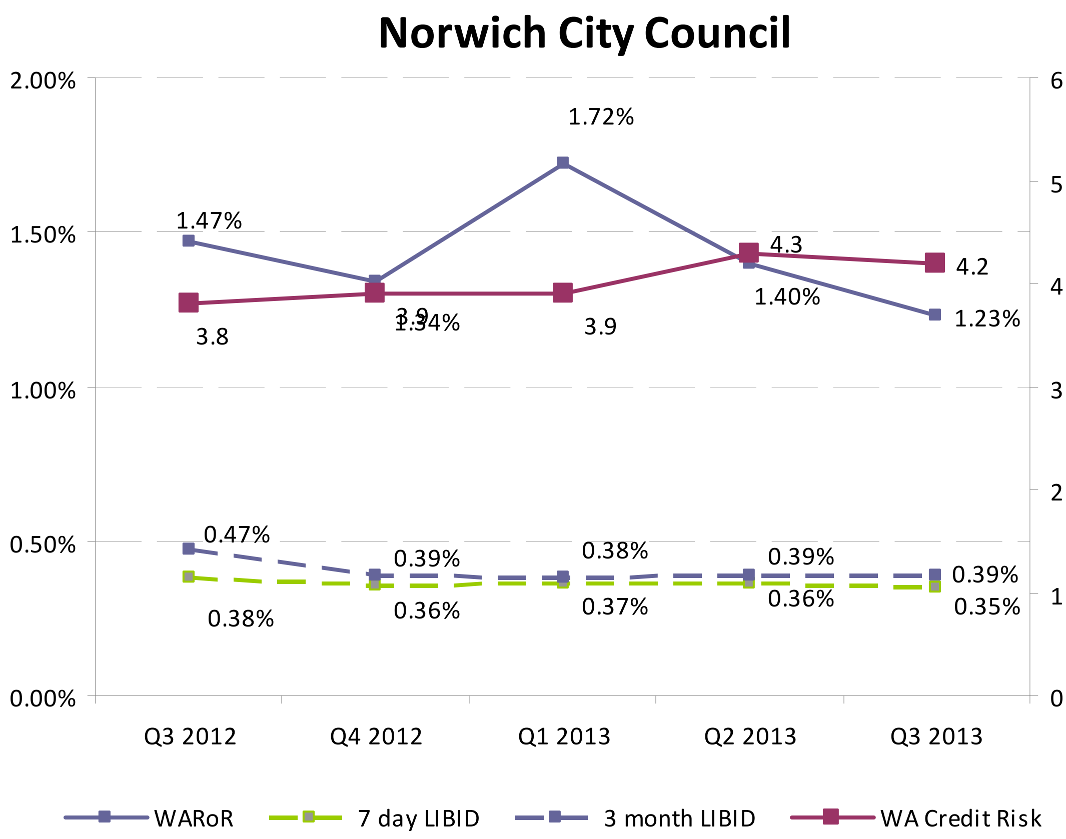
6 0 months

A number of 3.4 means between 6 months to a year

WAM – Weighted average time to maturity. This is the average time, in days, until the portfolio matures, weighted by the principle amount

WA Tot. Time – Weighted average total time. This is the average time, in days, that deposits are lent out for, weighted by the principle amount

Comparison of Key Data



Integrated impact assessment	NORWICH City Council

The IIA should assess **the impact of the recommendation** being made by the report

Detailed guidance to help with completing the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	Cabinet
Committee date:	11 December 2013
Head of service:	Caroline Ryba
Report subject:	Treasury Management Mid year Review
Date assessed:	
Description:	

	Impact			
Economic (please add an ‘x’ as appropriate)	Neutral	Positive	Negative	Comments
Finance (value for money)	☐	☒	☐	
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social (please add an ‘x’ as appropriate)	Neutral	Positive	Negative	Comments
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	
Equality and diversity (please add an ‘x’ as appropriate)	Neutral	Positive	Negative	Comments
Relations between groups (cohesion)	☒	☐	☐	

	Impact			
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☒	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues