RYEDALE
DISTRICT
COUNCIL

REPORT TO:	**COUNCIL**
DATE:	**9 JANUARY 2014**
REPORT OF THE:	**CORPORATE DIRECTOR (s151)** **PAUL CRESSWELL**
TITLE OF REPORT:	**TREASURY MANAGEMENT MID-YEAR REVIEW**
WARDS AFFECTED:	**ALL**

EXECUTIVE SUMMARY

1.0 PURPOSE OF REPORT

1.1 To report on the treasury management activities to date for the financial year 2013/14 in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (the Code).

2.0 RECOMMENDATIONS

2.1 It is recommended that:
(i) Members receive this report; and
(ii) The mid-year performance of the in-house managed funds to date is noted.

3.0 REASON FOR RECOMMENDATIONS

3.1 The Council has adopted the Code. A provision of the Code is that a mid-year review report must be made to the Full Council relating to the treasury activities of the current year.

4.0 SIGNIFICANT RISKS

4.1 There are significant risks when investing public funds especially with unknown institutions. However, by the adoption of the CIPFA Code and a prudent investment strategy these are minimised. The employment of Treasury Advisors also helps reduce the risk.

REPORT

5.0 BACKGROUND AND INTRODUCTION

5.1 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 ensures this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering

maximising investment return.

5.2 The second major function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide towards whether the Council has a borrowing need, 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.

5.3 Treasury management in this context 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."

5.4 The CIPFA Code of Practice on Treasury Management 2009 was adopted by this Council on 22 February 2010 and this Council fully complies with its requirements.

5.5 The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Full Council of an annual Treasury Management Strategy Statement (including the Annual Investment Strategy and Minimum Revenue Provision Policy) for the year ahead, a Mid-Year Review Report and an Annual Report covering activities during the previous year.
4. 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.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body, which in this Council is the Overview and Scrutiny Committee.

5.6 This mid-year report has been prepared in compliance with CIPFA's Code of Practice and covers the following:

- An economic update for the first seven months of 2013/14;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- A review of the Council's investment portfolio for 2013/14;
- A review of compliance with Treasury and Prudential Limits for 2013/14.

6.0 POLICY CONTEXT

6.1 The Council has adopted the CIPFA Code of Practice on Treasury Management in Local Authorities and this report complies with the requirements under this Code.

7.0 CONSULTATION

7.1 The Council uses the services of Sector Treasury Services Limited to provide treasury management information and advice.

8.0 REPORT DETAILS

Economic Update

8.1 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. 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. 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

8.2 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.

8.3 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 take 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.

8.4 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.

8.5 With regard to interest rates, Sector's view is that there is unlikely to be any increase in Bank Rate until the second quarter of 2016, rising to 1.25% in the first quarter of 2017. Sectors latest forecast for the Bank Rate is as follows:

Dec-2013	Dec-2014	Dec-2015	Mar-2016	Jun-2016	Sep-2016	Dec-2016	Mar-2017
0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.00%	1.25%

Treasury Management Strategy Statement and Annual Investment Strategy Update

8.6 The Treasury Management Strategy (TMSS) for 2013/14 was approved by this Council on 26 February 2013. 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. Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity

8.7 The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (maximum loan period of 12 months) and only invest with highly credit rated financial institutions, using Sector's suggested creditworthiness approach, including sovereign rating and credit default swap (CDS) overlay information provided by Sector.

8.8 Investments during the first seven months of the year have been in line with the strategy and there have been no deviations from the strategy.

8.9 As outlined above, there is still considerable uncertainty and volatility in the financial and banking market, both globally and in the UK. In this context, it is considered that the strategy approved on 26 February 2013 is still fit for purpose in the current economic climate.

Investment Portfolio 2013/14

8.10 In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity and to obtain an appropriate level of return which is consistent with the Council's risk appetite.

8.11 As set out earlier in the report, it is a very difficult investment market in terms of earning the level of interest rate commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate.

8.12 The Council's investment position at the beginning of the financial year was as follows:

Type of Institution	Investments (£)
UK Clearing Banks	5,750,000
Local Authorities	0
Building Societies	0
Total	5,750,000

8.13 A full list of investments held as at 31 October 2013, compared to Sectors counterparty list and changes to Fitch, Moodys and S&P's credit ratings during the first seven months of 2013/14 is shown in annex B and summarised below:

Type of Institution	Investments (£)
UK Clearing Banks	6,500,000
Foreign Banks	0
Building Societies	0
Local Authorities	0
Total	6,500,000

8.14 As illustrated in the economic background section above, investment rates available in the market are at a historical low point. The average level of funds available for investment purposes in the first seven months of 2013/14 was £10.5m. These funds were available on a temporary basis and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

8.15 The table below compares the investment portfolio yield for the first seven months of the year against a benchmark of the average 7 day LIBID rate of 0.36%.

	Average Investment (£)	Average Gross Rate of Return	Net Rate of Return	Benchmark Return	Interest Earned (£)
Cash Equivalents	4,713,037	0.56%	n/a	n/a	15,570
Fixed Term Deposits	842,682	0.81%	n/a	0.36%	27,320

8.16 The Council's budgeted investment return for 2013/14 is £90k and performance during the financial year to 31 October 2013 is £43k, which is £11k below the profiled budget.

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

Compliance with Treasury and Prudential Limits

8.18 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". The Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Strategy Statement (TMSS).

8.19 During the financial year to date the Council has 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 are shown in annex A.

8.20 The Council has no long-term borrowing and is likely to retains its status as a debt-free authority in the current financial year. There have been no temporary borrowing transactions in the year.

9.0 IMPLICATIONS

9.1 The following implications have been identified:

a) Financial

The results of the investment strategy affect the funding of the capital programme. The investment income return to 31 October 2013 was £43k, which is lower than estimated.

b) Legal

There are no additional legal implications within this report.

c) Other (Equalities, Staffing, Planning, Health & Safety, Environmental, Crime & Disorder)
There are no additional implications within this report.

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Background Papers:
None.

ANNEX A

PRUDENTIAL AND TREASURY INDICATORS

Prudential Indicators

Extract from budget setting report	2012/13 Actual	2013/14 Estimate	2014/15 Estimate	2015/16 Estimate
Capital Expenditure	**£1.968m**	**£4.289m**	**£0.860m**	**£0.700m**
Ratio of financing costs to net revenue stream	**1.31%**	**2.69%**	**2.57%**	**1.68%**
Net borrowing requirement	**-£5.405m**	**-£3.173m**	**-£2.668m**	**-£2.916m**
Capital Financing Requirement as at 31 March	**£0.295m**	**£2.327m**	**£2.832m**	**£2.585m**
Annual change in Capital Financing Requirement	**-£0.178m**	**£2.032m**	**£0.505m**	**-£0.247m**
Incremental impact of capital investment decisions Increase in council tax (band D) per annum	**N/a**	**£4.15**	**£6.61**	**£6.60**

Treasury Management Indicators

	2012/13	2013/14	2014/15	2015/16
	Actual	**Estimate**	**Estimate**	**Estimate**
Authorised Limit for external debt -				
Borrowing	N/a	£20.0m	£20.0m	£20.0m
Other long term liabilities	N/a	£1.0m	£2.0m	£2.0m
Total	N/a	£21.0m	£22.0m	£22.0m
Operational Boundary for external debt -				
Borrowing	N/a	£5.0m	£5.0m	£5.0m
Other long term liabilities	N/a	£0.3m	£1.1m	£0.9m
Total	N/a	£5.3m	£6.1m	£5.9m
Actual external debt	£0.295m	£2.327m	£2.832m	£2.585m
Interest rate exposure Borrowing:				
Limits on fixed interest rates	N/a	100%	100%	100%
Limits on variable interest rates	N/a	5%	5%	5%
Investments:				
Limits on fixed interest rates	N/a	100%	100%	100%
Limits on variable interest rates	N/a	50%	50%	50%
Upper limit for total principal sums invested for over 364 days (per maturity date)	N/a	£1.0m	£1.0m	£1.0m

ANNEX B

Investment Portfolio as at 31 October 2013

Investment by Institution	Investment £	Duration of Investment	Latest Sector Duration Band Rating	Sovereignty Rating
UK Clearing Banks				
National Westminster Bank	1,500,000	On Call	12 Months	AA+
Bank of Scotland	1,000,000	12 Months	12 Months	AA+
Bank of Scotland	500,000	12 Months	12 Months	AA+
National Westminster Bank	1,000,000	95 Day Notice	12 Months	AA+
National Westminster Bank	1,000,000	60 Day Notice	12 Months	AA+
Bank of Scotland	1,000,000	3 Months	12 Months	AA+
Bank of Scotland	500,000	3 Months	12 Months	AA+
Grand Total	**6,500,000**			

Fitch and Moodys Sovereignty Rating for the UK is AA+ while S&P's is AAA.
All the above borrowers met the required credit rating at the time of investment.