RHONDDA CYNON TAF COUNTY BOROUGH COUNCIL

MUNICIPAL YEAR 2013-2014

COUNCIL		**AGENDA ITEM NO.10**
27th November 2013	**TREASURY MANAGEMENT MID YEAR REVIEW 2013/14**	

REPORT OF :

THE GROUP DIRECTOR, CORPORATE SERVICES
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1.0 PURPOSE OF REPORT

1.1 This report constitutes the requirement to provide Members with information on :-

- the Council's Treasury Management activity during the first six months of 2013/14; and
- Prudential and Treasury Indicators for the same period.

2.0 RECOMMENDATIONS

2.1 It is recommended that Members note the content of this report.

3.0 INTRODUCTION

3.1 This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

3.2 The CIPFA Code of Practice on Treasury Management requires a Mid Year Review to be presented to Council. This report fulfils that requirement.

3.3 The Treasury Management function operates within the Strategy approved by Council 20th March 2013.

3.4 Treasury Management is defined as:
"The management of a local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

3.5 The Council sets a balanced budget to ensure that all planned expenditure is financed by various sources of income / reserves. Treasury Management is concerned with monitoring the cashflows of such income and expenditure and planning investments and borrowing prudently.

3.6 This report includes the following areas of treasury activity during the first six months of 2013/14 :

- Economic background;
- Borrowing activity and results;
- Estimated and actual treasury position and prudential indicators;
- Investment strategy, activity and results.

4.0 ECONOMIC BACKGROUND

4.1 General Economic Background

4.2 The Council's investment income is subject to changes in short term interest rates. The level of the Bank Base Rate is one of the main determinants of the rate of interest the Council receives on its short term investments. The Bank of England continued to maintain the bank rate at 0.5% throughout the first half of the year. This is expected to continue until late 2016 and will result in continued low investment income for the Council.

4.3 Growth has been on an upward trend during this six month period and indications are that economic recovery will continue into the next quarter. This is evidenced by:

- Business surveys pointing to growth (manufacturing / industrial & construction)
- Consumer spending continuing to rise
- Retail sales showing growth
- Annual growth in new car registrations
- Unemployment rate falling
- Ratio of full time to part time workers continued to rise
- Mortgage approvals rose to their highest level since Feb 2008
- House prices rising

4.4 The new governor of the Bank of England, Mark Carney, took office in July. The Bank introduced its new policy of forward guidance in which the Monetary Policy Committee (MPC) pledged not to raise interest rates until unemployment falls to 7%. This guidance will be over-ruled if:

- Inflation is forecast to be above 2.5% in 18-24 months, or
- Severe uncertainty on inflation expectations is apparent, or
- Financial position is threatened by monetary policy

4.5 The governor put the positive news of economic recovery into perspective by describing this growth as welcome but we still have a long way to go after the weakest recovery on record after a recession. Recovery needs to be strong and sustainable.

4.6 In addition, the positive news is to be tempered with the knowledge that consumer expenditure is likely to remain suppressed by inflation being higher than increases in earnings, i.e., disposable income continues to be eroded.

4.7 The majority of the Council's borrowing is from the PWLB (Public Works Loans Board). Long-term borrowing rates are influenced by gilt yields. As the UK is considered a "safe haven" for surplus cash, this demand keeps gilt yields and therefore PWLB rates at historically low levels.

4.8 The expected longer term trend for PWLB borrowing rates is for them to rise. Increasing investor confidence in economic recovery will encourage investors to switch from bonds to riskier equities, thereby increasing PWLB rates.

4.9 PWLB rates during the first half of the financial year were as follows:

	5 years	**10 years**	**25 years**	**50 years**
Average	2.15%	3.22%	4.15%	4.23%
Highest	2.76%	3.86%	4.49%	4.51%
Lowest	1.61%	2.60%	3.72%	3.84%

4.10 Estimates of future rates are as follows:

	Base Rate	**PWLB rates**			
		5 years	**10 years**	**25 years**	**50 years**
2013/14 (Act 6 mth Average)	0.5%	2.15%	3.22%	4.15%	4.23%
31/03/14	0.5%	2.5%	3.7%	4.4%	4.4%
31/03/15	0.5%	2.8%	3.9%	4.6%	4.7%

5.0 BORROWING ACTIVITY AND RESULTS

5.1 The borrowing strategy for 2013/14 approved by Council in March 2013 reported that the Section 151 Officer, under delegated powers, will take the most appropriate form of borrowing depending upon the prevailing interest rates at the time, taking into account advice provided by our advisors.

5.2 In March, the borrowing requirement was estimated to be £22m based on the Capital Programme at that time. In line with changes to the Capital Programme, this year's borrowing requirement has increased to £50m.

5.3 It was also reported that the Council may reschedule debt where there is an opportunity to generate savings. I can report to you that to date this financial year, the Council has not undertaken any borrowing and has not rescheduled debt. To minimise counterparty risk, the Council is maintaining low cash levels and using its accumulated cash balances in lieu of borrowing to fund the capital programme. This is termed "internal borrowing" and is a risk management tool that minimises interest cost in addition to reducing counterparty risk. Based on cashflow projections, it is likely we will undertake short term borrowing to meet cash shortfalls as we are close to the point where internal borrowing has been maximised. However, this approach of taking short term borrowing may change if longer term interest rates are at risk of increasing significantly. In this case, long term borrowing may be undertaken.

5.4 In line with the above strategy, this Council has not borrowed in advance of need during the first 6 months of the year and has no intention to borrow in advance during 2013/14.

5.5 The projected out-turn for net capital charges for 2013/14 is currently £24.069m against a budget of £24.261m. This is being achieved despite the challenges faced with investment income and maintaining our low risk strategy. As discussed above, to minimise investment exposure on cash balances held, no long term borrowing has yet been undertaken this financial year.

6.0 CERTAINTY RATE

6.1 During August 2012, HM Treasury introduced "the certainty rate", whereby local authorities are able to access borrowing at 0.2% cheaper than published PWLB rates. In order to access the discounted rate, authorities were required to provide Welsh Government (and onward, the Debt Management Office) with an indication of their potential borrowing requirements for the next 3 years. This Council has provided such information in order to access the discounted rate.

7.0 ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

7.1 Members will also be aware that Council approved Prudential Borrowing to fund a new secondary school and leisure facility at Aberdare. This project is included in the calculation of the Council's Prudential Indicators.

7.2 During the six months to September 2013, the Council operated within its prudential limits set out in the Prudential Code report approved in March 2013. Details of limits and actual performance are as follows:

7.3 Capital Expenditure and the Capital Financing Requirement

7.3.1 The Capital Expenditure plans of the Council are primarily financed by capital receipts and capital grants. The remaining element which cannot be immediately financed from other resources will constitute our borrowing requirement. The estimated level of available capital resources is provided in summary as the Capital Expenditure Indicator below.

Indicator : Capital Expenditure

	2013/14 Projected Outturn £M	2013/14 Original Estimate £M	2014/15 Revised Estimate £M	2015/16 Revised Estimate £M
Supported spend	58.751	35.237	25.384	21.275
Unsupported spend	43.106	14.773	26.399	0.529
Total spend	101.857	50.010	51.783	21.804
Financed by:-				
Borrowing	50.140	21.807	33.433	7.563
Other Capital Resources (Grants, Capital Receipts)	51.717	28.203	18.350	14.241

7.3.2 The Capital Financing Requirement (CFR) represents the Council's underlying need to borrow for capital purposes. The CFR is capital expenditure that has not yet been paid for from either revenue or capital resources.

7.3.3 The Council's expectations for the CFR in the next three years is shown below:

Indicator : Capital Financing Requirement (CFR)

	31/03/14 Projected Outturn £M	2013/14 31/03/14 Original Estimate £M	2014/15 31/03/15 Revised Estimate £M	2015/16 31/03/16 Revised Estimate £M
CFR	391.592	360.672	409.872	402.508
Net movement in CFR			49.200	(7.364)

7.3.4 The expected external debt for each year is as detailed below.

Indicator : External Debt

	30/09/13 Actuals £M	2013/14 31/03/14 Original Estimate £M	2013/14 31/03/14 Revised Estimate £M	2014/15 31/03/15 Revised Estimate £M	2015/16 31/03/16 Revised Estimate £M
Borrowing	197.378	217.112	247.445	297.733	330.251
Other long term liabilities	27.585	27.571	27.571	26.423	25.227
Total External Debt	224.963	244.683	275.016	324.156	355.478

7.3.5 Long Term Liabilities include the Council's obligation under its PFI scheme and finance leases.

8.0 LIMITS TO BORROWING ACTIVITY

8.1 The first key control over the Council's activity is to ensure that, over the medium term, borrowing will only be for a capital purpose. The Council needs to ensure that external borrowing does not exceed the total of the capital financing requirement in the preceding year plus the estimate of the additional capital financing requirement for the next three financial years. This allows some flexibility within a three-year period to deliver an effective treasury management strategy.

Borrowing Activity (Gross Borrowing)

	30/09/13 Actuals £M	2013/14 31/03/14 Original Estimate £M	2013/14 31/03/14 Revised Estimate £M	2014/15 31/03/15 Revised Estimate £M	2015/16 31/03/16 Revised Estimate £M
Gross Borrowing (inc. Other Long Term Liabilities)	224.963	244.683	275.016	324.156	355.478
Capital Financing Requirement		360.672	391.592	409.872	402.508

8.2 The Authorised Limit represents the limit beyond which borrowing is prohibited, and needs to be set, monitored and revised by Members. It reflects the maximum level of borrowing to fund existing capital commitments, which could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some added headroom for unexpected movements.

Indicator : The Authorised Limit

	2013/14 30/09/13 Actuals £M	2013/14 Limit £M	2014/15 Limit £M	2015/16 Limit £M
Gross Borrowing	197.378	332.000	333.000	334.000
Other long term liabilities	27.585	28.000	27.000	26.000
Authorised Limit	224.963	360.000	360.000	360.000

8.3 The Operational Boundary is based on the probable external debt during the course of the year; actual borrowing could vary around this boundary, for short times, during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

Indicator : The Operational Boundary

	2013/14 30/09/13 Actuals £M	2013/14 Estimate £M	2014/15 Estimate £M	2015/16 Estimate £M
Gross Borrowing Limit	197.378	217.000	253.000	279.000
Other long term liabilities	27.585	28.000	27.000	26.000
Operational Boundary	224.963	245.000	280.000	305.000

9.0 AFFORDABILITY PRUDENTIAL INDICATORS

9.1 Previous sections have covered overall capital and control of borrowing indicators, but there is also a requirement to assess the affordability of capital investment plans. This provides an indication of the impact of the capital investment plans on the overall Council finances.

9.2 The Ratio of Financing Costs to Net Revenue Stream identifies the trend in the cost of capital (borrowing costs net of interest and investment income) against the "net revenue stream". The net revenue stream for the General Fund is the amount collectable from Council Tax payers added to the Council's Rate Support Grant (RSG) and Non Domestic Rates (NDR). The key use of this indicator is to compare trends in the ratio of financing costs to the net revenue stream, over time.

Indicator : Ratio of Financing Costs to Net Revenue Stream

	2013/14 Original Est	2013/14 Revised Estimate	2014/15 Revised Estimate	2015/16 Revised Estimate
General Fund	5.57%	5.70%	5.91%	6.04%

9.3 The Code requires limits to be set for :

I. Upper limits on variable rate exposure – this indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

II. Upper limits on fixed rate exposure – similar to the above indicator this covers a maximum limit on fixed interest rates.

Indicator : Interest Rate Exposure

	2013/14 Actuals as at 30/09/13	2013/14 Out-turn as at 30/09/13	2013/14 Limit	2014/15 Limit	2015/16 Limit
Borrowing					
Limits on fixed rates	62%	69%	55%-90%	55%-90%	55%-90%
Limits on variable rates	38%	31%	10%-45%	10%-45%	10%-45%
Investments					
Limits on fixed rates	0%	0%	0%-25%	0%-25%	0%-25%
Limits on variable rates	100%	100%	75%-100%	75%-100%	75%-100%
Net Borrowing					
Limits on fixed rates	66%	70%	55%-125%	55%-125%	55%-125%
Limits on variable rates	34%	30%	-25%-45%	-25%-45%	-25%-45%

9.4 For monitoring interest rate exposure purposes, LOBO's are included as variable rate debt. Although not a requirement of the Prudential Code, an internal limit of LOBO debt is set as follows:

	Limit	Actual 30/09/13	Estimate 31/03/14
£m	100	85.5	85.5
% of Debt Portfolio	45	38	31

9.5 The maturity structure indicator sets gross limits to reduce the Council's exposure to large fixed rate sums falling due for refinancing annually. The Code of Practice now requires LOBO's to be represented in the maturity structure at the next option date, hence the table below demonstrates a high maturity within 12 months. It is the view of our advisors that it is unlikely the LOBO's will be called within this financial year.

Indicator : Maturity Structure

	2013/14 Out-turn as at 30/09/13	Upper Limit	Lower Limit
Under 12 months	31%	60%	0%
12 months to 2 years	0%	60%	0%
2 years to 5 years	1%	60%	0%
5 years to 10 years	0%	70%	0%
10 years to 20 years	11%	90%	0%
20 years to 30 years	0%	90%	0%
30 years to 40 years	29%	90%	0%
40 years to 50 years	28%	90%	0%

9.6 In order to maximise investment returns there could be opportunities for sums to be invested for longer than one year. This would only be undertaken with a prudent view of the primary considerations of security and liquidity.

Indicator : Total principal funds invested for periods longer than 364 days

	Limit	31/03/14 Estimate
Maximum principal sums invested over 1 year	£15m	£1m

9.7 The funds invested with a maturity period of greater than 1 year is an operational investment (as opposed to a treasury investment) relating to the Local Authority Mortgage Scheme (LAMS) which Members approved during July 2012.

9.8 To date, during 2013/14, there have been no treasury investments with a maturity of greater than 1 year. Given the circumstances and objectives outlined in the Investment Strategy, it is unlikely the Council will invest for periods greater than one year.

10.0 INVESTMENT STRATEGY, ACTIVITY & RESULTS

10.1 The Council manages its investments in-house, investing in line with the Council's approved lender criteria as approved by Council on the 20th March 2013.

10.2 Members will recall that following the onset of the unprecedented national and international economic crisis in 2008, all of this Council's cash flows are currently being invested in the Debt Management Account Deposit Facility and other Government backed public sector bodies, in line with the aforementioned approved strategy. This strategy ensures we prioritise **S**ecurity (protecting monies invested), then **L**iquidity (cashflow) and finally **Y**ield (return on investment). The order of these "SLY" priorities are detailed in Investment Guidance produced by the Welsh Government.

10.3 I have kept this under constant review subsequently with a view to returning to market investment activity at an appropriate time. To date, the Council has not returned to market investments but has set up a number of AAA rated money market funds to provide further diversification options when the opportunity does arise. These accounts have not been used during 2013/14. Members will be kept informed of any changes as part of the Council's quarterly performance reports.

10.4 The following table shows the overall result of the investment activities undertaken by the Council:

	Interest Received £M	Average Cash Balance £M	Return on Investments %	Benchmark Return %
General Balances	0.059	18.51	0.32	0.37

The benchmark for Local Authority internally managed funds is the average 7-day LIBID rate.

10.5 As a result of our low risk strategy, our return on investment is lower than the benchmark return. The Economic Background section of this report set out the continuing difficulties in economic conditions during this period. As a result of these conditions, interest rates remained low impacting adversely on investment returns.

10.6 The failure of the Icelandic banking system in October 2008 had a major impact on local authority investments across the UK. Over 100 local authorities had deposits of almost £1bn with these institutions. Members will be aware that the Council had £3.0M invested with Heritable Bank. During August 2013, the Council received a further dividend. The total value recovered is now £2.829m being 94% of the original principal investment.

11.0 LOCAL AUTHORITY MORTGAGE SCHEME (LAMS)

11.1 As approved by Council on 4th July 2012, the Council launched the Local Authority Mortgage Scheme during September 2012, which supports First Time Buyers in purchasing a home. The scheme is facilitated by Lloyds Bank and allows First Time buyers to access 95% loan to value mortgages on terms similar to 75% loan to value mortgages. The bank is able to offer such loans where the Council guarantees the loan up to 20% of the value of the property. It is a requirement of the scheme that the Council places a deposit with the bank for the length of the indemnity. Therefore the Council has a deposit of £1m with Lloyds for 5 years.

12.0 TREASURY MANAGEMENT ADVISORS

12.1 Capita Asset Services Ltd., part of the Capita Group (formerly Sector Treasury Services), continues to support the Council's Treasury Management function. The contract expires 31st March 2014.

13.0 TRAINING

13.1 Sector (as was) facilitated a training session to the Corporate Services Scrutiny Committee on the 9th October 2012. Members received a presentation to assist them in their scrutiny responsibilities in relation to Treasury Management. As there have been no changes in the function of the committee with regards to Treasury Management, neither has there been any significant changes to Codes of Practice, there has been no further training required.

13.2 On 25th September 2013, officers attended a seminar hosted by Capita to increase awareness of the economic environment, interest rate forecasts and associated implications for the Council.

14.0 MINIMUM REVENUE PROVISION (MRP)

14.1 In accordance with legislative requirements applicable to local government (Local Government Act 2003), there is a requirement to charge an amount to revenue each year in respect of capital expenditure that is funded by borrowing. This charge is known as Minimum Revenue Provision (MRP).

14.2 The methods of charging MRP for Supported Borrowing and PFI and Finance leases are defined by regulations. The Group Director – Corporate Services has discretion with regard to the method of charging MRP to Council Fund Balances in respect of Unsupported Borrowing only.

15.0 CONCLUSION

15.1 2013/14 financial year continues to be a further extremely challenging year for treasury management and this report highlights for Members the Treasury Management activities that have been undertaken during this period.

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