Treasury Management Interim Report **Appendix C**
Seven months to 31 October 2014

This report ensures the council demonstrates best practice in accordance with CIPFA's recommendations in their Code of Practice for Treasury Management, by keeping members informed of treasury management activity.

1. The UK Economy

1.1. Little change in the UK economic climate and statistics since previously reported:

- The first estimate of GDP for the third quarter shows GDP growing by 0.7%. The economy has now been growing by 0.7% to 0.9% for each of the last six quarters.
- The year-on-year Consumer Price Index (CPI) was 1.2% in September 2014, down from 1.5% in August..
- The latest statistics released for the quarter to August 2014 show the UK labour market continuing with employment gains, albeit at a slower pace, and the headline unemployment rate falling to 6.0%, the lowest since late 2008. Earnings growth has picked up slightly.
- There has been no change in the Bank Base Rate.

2. Outlook for Interest Rates

2.1 With slack in the labour markets, low inflation and weak earnings growth, the council's treasury advisers, Arlingclose, continue to forecast the first increase in the Bank Base rate to be in the third quarter of 2015. Their interest rate forecast is as follows:

Bank Rate	**Dec-14**	**Mar-15**	**Jun-15**	**Sep-15**	**Dec-15**	**Mar-16**	**Jun-16**	**Sep-16**	**Dec-16**	**Mar-17**
Upside risk		+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.50
Central case	**0.50**	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.50**
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00

3. The Council's Investments

3.1 At 31st October 2014 the council held the following investments:

Investment	**Term**	**Maturity Date**	**Interest Rate**	**Amount invested £m**	**£m**
Instant Access Bank Accounts:					
Handelsbanken	N/A	N/A	0.45%	5.00	5.00
Instant Access Money Market Funds:					
Ignis	N/A	N/A	0.49%	4.82	
Federated	N/A	N/A	0.46%	3.10	7.92
1 Month Notice Account					
Close Bros	N/A	N/A	1.00%	5.00	5.00
Fixed Term Deposits:					
Nationwide	298 days	23/01/15	0.72%	2.00	
Barclays	365 days	19/02/15	0.85%	1.00	
Nationwide	279 days	25/03/15	0.79%	2.00	
Barclays	279 days	25/03/15	0.79%	1.00	
Lloyds	364 days	27/03/15	0.95%	1.00	
Barclays	364 days	27/03/15	0.86%	1.00	
Bank of Scotland	364 days	30/03/15	0.95%	2.00	
Barclays	364 days	30/03/15	0.86%	1.00	11.00

Total			**0.70%**		**28.92**
No new term deposits made in the last two months.					

3.2 There has been little change in investment rates over the last two months.

3.3 The council's current eligible UK counterparties and their associated maximum maturity periods (as recommended by the council's treasury advisers, Arlingclose) are as follows:

Counterparty	**Maximum maturity period from:**		
	01/04/14	**01/07/14**	**16/10/14**
Close Brothers Ltd, Goldman Sachs International Bank, 15 of the stronger building societies	100 days	100 days	100 days
Santander UK	6 months	13 months	6 months
Bank of Scotland and Lloyds TSB	12 months	13 months	6 months
Nationwide	12 months	13 months	6 months
Barclays	12 months	13 months	100 days
HSBC and Standard Chartered Bank	12 months	13 months	6 months
Nat West and RBS	Overnight	Overnight	Overnight

3.4 The only non-UK counterparty that the council is using is Handelsbanken which had a recommended maximum maturity limit of 13 months but this was revised down to 6 months from 16th October when Arlingclose recommended a general tightening of limits.

3.5 Arlingclose cited the reason for the tightening of maturity limits to be as follows:

- "Bailing in" before "Bailing out"
  The European Parliament approved the Bank Recovery and Resolution Directive (BRRD) earlier this year. The BRRD effectively makes it illegal for governments to provide financial support until banks have defaulted on unsecured creditors (known as "bailing in"). The UK government has already legislated for a bail in power and this will be revised to be BRRD compliant from January 2015.
  Because of this, the credit rating agencies are starting to downgrade banks long-term credit ratings to reflect reduced government support going forward.
  Arlingclose consider that the first UK bank to have its long-term credit rating reduced below the recommended minimum of A- could be Barclays which is why the maturity limit for Barclays has been tightened more than the other banks in the table above. However, Arlingclose stress that they have no particular issues with Barclays' creditworthiness and are not suggesting the breaking of existing term deposits.

- Deteriorating global growth prospects
  Arlingclose consider a tightening of maturity limits to be a prudent response to deteriorating global growth prospects, particularly in the Eurozone.

3.6 The council has earned interest on its investments as follows:

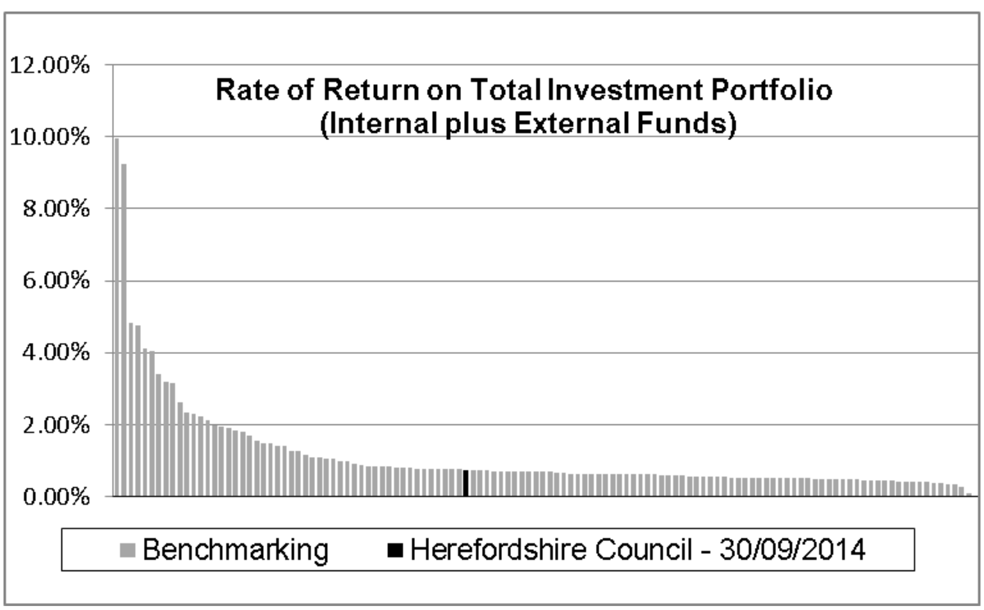
Month	**Average amount invested**		**Average rate of interest earned**		**Amount of interest earned /**	**Budget**	**Actual Surplus / *Forecast***
	Actual /	**Budget**	**Actual /**	**Budget**		**£**	

	Forecast £m	£m	*Forecast* %	%	*Forecast* £		£
Apr-14	35.09	20	0.68	0.60%	19,442	**10,000**	9,442
May-14	40.21	40	0.63	0.60%	21,584	**20,000**	1,584
Jun-14	33.96	40	0.68	0.60%	19,151	**20,000**	-849
Jul-14	37.30	40	0.66	0.60%	20,896	**20,000**	896
Aug-14	38.29	40	0.63	0.60%	20,652	**20,000**	652
Sep-14	32.90	40	0.66	0.60%	17,970	**20,000**	-2,030
Oct-14	29.72	30	0.70	0.60%	17,726	**15,000**	2,726
					137,421	**125,000**	**12,421**
Nov-14	*30.00*	30	*0.70*	0.60%	*17,500*	**15,000**	*2,500*
Dec-14	*30.00*	30	*0.65*	0.60%	*16,250*	**15,000**	*1,250*
Jan-15	*20.00*	20	*0.60*	0.60%	*10,000*	**10,000**	-
Feb-15	*20.00*	20	*0.60*	0.60%	*10,000*	**10,000**	-
Mar-15	*10.00*	10	*0.60*	0.60%	*5,070*	**5,070**	-
Budget and projected outturn					***196,241***	**180,070**	***16,171***

3.7 Investment balances in April were higher than budgeted resulting in a surplus for the month of £9,442. In September there was a deficit due to investment balances being lower than budgeted, however, this was more than offset by a surplus in October due to the average interest rate earned being higher than anticipated.

3.8 The projected outturn for the year is a surplus of around £16,000.

3.9 Arlingclose prepare quarterly benchmarking reports which show the rate of interest earned by the council compared to their other clients. The most recent one as at the end of September is shown below.



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3.10 As can be seen from the above, the council is receiving a rate of return on its investments consistent with most of Arlingclose's other clients, however, some councils are receiving a significantly higher return. These tend to be councils with long-term investments. For example the CCLA's Local Authorities Property Fund (which invests in commercial property) is proving popular with 81 councils currently invested in the Fund. The Fund pays a dividend of around 4-5% pa in addition to recent rising capital prices. Our current Treasury Management Policy Policy is to use short term investments and short term borrowing as cash balances require, if we secured longer term investment we would need to take out longer term (and more expensive) borrowing.

3.11 At present the council uses its reserves to reduce its borrowing requirement but the possibility of placing some of its core cash balances in longer-dated investment vehicles was discussed with Arlingclose. With short-term borrowing rates at less than 1% the investment would yield a net return, but it was agreed that it was not an option the council should pursue at the current time. The council complies with the CIPFA priorities of security, liquidity and yield (in that order) and in order to maximise the security of sums invested the council's strategy is to keep investments balances low and relatively liquid.

3.12 The council's cashflow forecast shows investment balances falling sharply at the end of December and continuing to fall thereafter. The council has therefore given one months notice to withdraw the £5 million with Close Bros. Because of this the average rate of interest earned will fall by about 0.10% in subsequent months and this is reflected in the forecast at 3.6 above.

4. The Council's Borrowing

Short-term borrowing

4.1 The council is continuing its policy of utilising short-term borrowing from other local authorities to fund its capital programme and for short-term liquidity needs. These short-term interest rates are significantly below levels available from other sources.

4.2 Historically the council has always borrowed for longer periods at fixed interest rates. Whilst achieving stability in the amount of its interest payments, the council currently has a large cost of carry when comparing its fixed interest debt to current (variable) investment rates.

4.3 It is considered good practice to have an element of variable rate borrowing that removes or reduces this cost of carry and, to the extent that the level of short-term debt does not exceed the level of the council's investments, when interest rates rise increased investment income provides a hedge against increased borrowing costs.

4.4 The council can only borrow up to its Capital Financing Requirement, which represents the need to borrow for capital spend, and cannot borrow beyond this to finance the revenue budget.

4.5 At the end of October 2014 short-term borrowing from other local authorities consisted of eleven loans totalling £33.50 million with an average rate of interest payable of 0.49%. Loan periods and interest rates (including brokers commission of between 0.03% and 0.10%) ranged from 76 days to one year and 0.40% to 0.58% respectively.

Long-term borrowing

4.6 No long-term loans have been taken out in the period to date.

4.7 The budget includes provision to take out up to £10 million of longer term loans from the Public Works Loan Board.

4.8 Due to fears for the Eurozone, demand for UK gilts are currently keeping interest rates low. The 20 year rate for an EIP loan (Equal Instalments of Principal repaid every six months over the term of the loan) is currently around 3.00% with the rate for a twenty year maturity loan (principal repaid at the end of the term) being around 3.80%.

4.9 However, the Monetary Policy Committee believe that the appropriate level for the Bank Base Rate for the post-crisis economy will be significantly lower than the previous norm. Arlingclose estimate this to be between 2.5% and 3.5% and are forecasting a very slow increase in the Base Rate.

4.10 This being the case, if the council was to take out a twenty year loan at 3.00% it is likely that there would be a significant cost of carry for at least the first five to ten years when compared to short-term borrowing rates.

4.11 It is recognised that there is a risk that rates will rise faster and higher than is forecast so PWLB rates will continue to be monitored and the council strategy kept under review.

4.12 The current capital financing budget position is summarised below.

Summary of Borrowing Budget	**Budget**	**Forecast**	**Savings**
	£m	**£m**	**£m**
Minimum Revenue Provision	**10.19**	**9.93**	**0.26**
Interest on existing longer-term PWLB and bank loans	**5.52**	**5.52**	-
Variable rate borrowing Budget Borrowing required £68 million Rate 1.00%	**0.55**	**0.20**	**0.35**
Fixed rate borrowing Budget Provision for longer term-borrowing	**0.10**	**0.10**	**-**
Less capitalised interest (see 3.11 below)	**(0.30)**	**(0.30)**	**-**
Forecast savings compared to budget	**16.06**	**15.45**	**0.61**

4.13 The reduction in the Minimum Revenue Provision required for 2014/15 is due to slippage in the capital spend for 2013/14, as reported in June.

4.14 The council is able to capitalise interest costs relating to interest paid on borrowing used to fund large capital schemes that take substantial periods of time to get to the point at which the assets may be utilised. Such interest, incurred at the construction or installation phase, may be added to the cost of the associated asset. At can be seen from the table above, capitalised interest of £300,000 has been included in the 2014/15 budget for capital financing costs.

5. Summary of Outturn Position

5.1 The current net treasury position, compared to budget, is estimated to be a surplus of £630,000.

Summary of Budget Over/(Under) Spend	**£m**
Treasury Management investment income receivable	(0.02)
Interest payable on borrowing	(0.61)
Total savings	**(0.63)**

5.2 The savings will be £100,000 greater if no longer-term fixed rate borrowing is taken out.

5.3 The savings will also be higher/lower if capitalised interest is more/less than £300,000.