

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 Economy

### 1.1. Recent economic events and statistics show the following:

- The outlook for UK growth has improved although it remains subdued. GDP growth in the first quarter was 0.3% with recent survey data suggesting growth in the second quarter could be 0.6%.
- The year-on-year Consumer Price Index (CPI) for May 2013 was 2.7%.
- Recent data suggests the recession at the aggregate Eurozone level may be bottoming out although recessionary conditions will prevail for the medium to long term for weaker members.
- Relatively good economic data from the US has led to an expectation that there will be a reduction in the Federal Reserve's bond-buying programme towards the end of the year. This has led to an increase in bond yields in America which has had a knock-on effect on other financial markets, including gilt yields which have also risen sharply in recent weeks.

## 2. The Council's Investments

2.1 At 31<sup>st</sup> May 2013 the council held the following investments. As previously noted the council will take advantage of very low cost borrowing from other councils in order to save the local tax payer the cost of borrowing at a higher rate from PWLB.

Investment	Term	Maturity Date	Interest Rate	Amount invested	
				£m	£m
<u>Instant Access Bank Accounts:</u>					
National Westminster	N/A	N/A	0.60%	1.00	1.00
<u>Instant access Money Market Funds:</u>					
Prime Rate	N/A	N/A	0.43%	5.00	
Ignis	N/A	N/A	0.43%	5.00	
Insight	N/A	N/A	0.34%	1.39	11.39
<u>95 day notice accounts</u>					
National Westminster	N/A	N/A	0.80%	3.00	
Royal Bank of Scotland	N/A	N/A	0.95%	3.50	
Santander	N/A	N/A	1.10%	7.00	13.50
<u>1 month notice account</u>					
Close Bros	N/A	N/A	1.00%	7.00	7.00
<u>Fixed Term Deposits:</u>					
Lloyds	92 days	01/08/13	0.70%	3.00	
Nationwide	273 days	11/09/13	0.76%	2.00	
Bank of Scotland	156 days	25/09/13	0.76%	4.00	
Lloyds	186 days	25/10/13	0.80%	3.00	
Barclays	365 days	01/11/13	1.07%	2.00	
Gateshead Council	549 days	18/11/13	1.10%	2.00	
Barclays	364 days	29/11/13	1.00%	1.00	
Barclays	365 days	05/12/13	1.00%	1.00	
Barclays	367 days	21/04/14	0.87%	1.00	19.00

<b>Total</b>			<b>0.81%</b>		<b>51.89</b>
Shaded investments represent term deposits made in the last two months to 31 <sup>st</sup> May 2013					

- 2.2 The council's current eligible UK counterparties, together with the maximum maturity periods (as recommended by the council's treasury advisers, Arlingclose), are as follows:

<b>Counterparty</b>	<b>Maximum maturity period</b>
Close Brothers Ltd	100 days
Santander UK	100 days
Nat West and RBS	6 mnths
Bank of Scotland and Lloyds TSB	6 mnths
Nationwide	12 mnths
Barclays	12 mnths
HSBC and Standard Chartered Bank	12 mnths

- 2.3 There have been no changes to the above limits in 2013/14.

- 2.4 The council's Treasury Management advisers, Arlingclose, have issued the following forecast of the Bank Base Rate. They believe that it could be 2016 before the first increase in the Bank Base Rate.

<b>Bank Rate</b>	<b>Sep-13</b>	<b>Dec-13</b>	<b>Mar-14</b>	<b>Jun-14</b>	<b>Sep-14</b>	<b>Dec-14</b>	<b>Mar-15</b>	<b>Jun-15</b>	<b>Sep-15</b>	<b>Dec-15</b>
<b>Upside risk</b>			+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50
<b>Central case</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>	<b>0.50</b>
<b>Downside risk</b>	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

- 2.5 The council has earned interest on its investments as follows:

<b>Month</b>	<b>Amount invested</b>		<b>Average rate of interest earned</b>		<b>Amount of interest earned / Forecast £</b>	<b>Budget £</b>	<b>Actual Surplus / Forecast £</b>
	<b>Actual / Forecast £m</b>	<b>Budget £m</b>	<b>Actual / Forecast %</b>	<b>Budget %</b>			
Apr-13	30.41	30	0.82%	0.70%	20,025	17,500	2,525
May-13	50.50	40	0.83%	0.70%	35,667	23,000	12,667
<b>Total to 31<sup>st</sup> May</b>						<b>40,500</b>	<b>15,192</b>
Jun-13	50.00	40	0.83%	0.70%	35,000	23,000	12,000
Jul-13	50.00	40	0.80%	0.70%	33,000	23,000	10,000
Aug-13	45.00	35	0.75%	0.70%	28,000	20,000	8,000
Sep-13	40.00	35	0.70%	0.70%	23,000	20,000	3,000
Oct-13	40.00	30	0.70%	0.70%	23,000	17,500	5,500
Nov-13	40.00	25	0.70%	0.70%	23,000	14,500	8,500
Dec-13	35.00	20	0.65%	0.70%	19,000	11,500	7,500
Jan-14	35.00	20	0.65%	0.70%	19,000	11,500	7,500

Feb-14	20.00	15	0.60%	0.70%	10,000	8,820	1,180
Mar-14	20.00	15	0.60%	0.70%	10,000	8,750	1,250
<b>Projected outturn</b>					<b>278,692</b>	<b>199,070</b>	<b>79,622</b>

- 2.6 The interest received in the two months to 31<sup>st</sup> May 2013 has exceeded budget due to both the amounts invested and the average interest rates achieved being higher than the budgeted amounts.
- 2.7 In recent months interest rates on the council's instant access bank accounts have fallen sharply. In order to maintain investment income the council is utilising 95 day notice accounts with an increased reliance on short-term borrowing to provide liquidity. This policy results in investment balances being higher when compared to budget or to balances in 2012/13.

### **3. The Council's Borrowing**

#### **Short-term borrowing**

- 3.1 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. This is good practice as the rates are below levels available from other sources.
- 3.2 The council can only borrow up to its Capital Financing Requirement and cannot borrow beyond this to finance the revenue budget.
- 3.3 At the end of May 2013 short-term borrowing from other local authorities consisted of eight loans totalling £21 million.
- 3.4 In the two months to 31<sup>st</sup> May 2013 the council has taken out six loans for between £2 million to £5 million each, for periods ranging from 5 days to 153 days and for interest rates varying from 0.34% to 0.38%, including brokers commission.

#### **Long-term borrowing**

- 3.5 No long-term loans have been taken out in the period to date.
- 3.6 In recent weeks PWLB rates have risen significantly. This follows a worldwide increase in the yields on government debt, as noted in 1.1 (PWLB rates being set at their equivalent gilt yields plus a margin of around 1%). However, Arlingclose believe that the recent climb in rates is overdone considering the global economic outlook.
- 3.7 Arlingclose have issued the following forecast of the interest rate on a PWLB 10 year maturity loan or 20 year EIP loan (EIP being where the loan is repaid in equal instalments every six months over the period of the loan):

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
<b>Upside risk</b>	+0.50	+0.50	+0.50	+0.50	+0.65	+0.75	+0.85	+1.00	+1.00	+1.00
<b>Central case</b>	<b>3.25</b>	<b>3.25</b>	<b>3.30</b>	<b>3.35</b>	<b>3.40</b>	<b>3.50</b>	<b>3.60</b>	<b>3.70</b>	<b>3.80</b>	<b>3.90</b>
<b>Downside risk</b>	-0.50	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65

The above table is a forecast of Standard PWLB rates. The council is able to borrow at the "Certainty Rate" which was introduced from November 2012 and is 0.20% less.

- 3.8 The above forecast was issued on 28<sup>th</sup> June 2013 when the PWLB 10 year maturity loan rate stood at 3.49%. The “central case” of Arlingclose’s forecast shows the extent to which they believe that rates are currently over-inflated. However, the upside and downside risk margins reflect the difficulty in making the forecast.
- 3.9 Whilst PWLB rates are at relatively low levels compared to their historic levels there is still a large differential between PWLB rates and:  
a) the rates currently earned on the council’s investments; and  
b) the rates available on short-term loans from other local authorities.
- 3.10 The costs and benefits of longer term borrowing, relative to shorter term borrowing, continue to be monitored and discussed with the council’s treasury adviser Arlingclose. Despite the uncertainty over future movement in PWLB rates, at present their advice is to continue using short-term loans and delay taking out more expensive longer-term finance.
- 3.11 The Treasury Management Strategy for 2013/14 estimated that additional new loans of £34 million may be needed to cover both borrowing required for the 2013/14 capital programme and the forecast fall in council reserves (which mean that the council has to externalise internal borrowing from previous years). The original budget included higher interest rates associated with PWLB borrowing but the budget has since been reviewed and revised to include further short-term finance. The position is summarised below.

<b>Summary of Borrowing Budget</b>	<b>Note</b>	<b>Budget</b>	<b>Forecast</b>	<b>(Over-spend) / Saving</b>
		<b>£m</b>	<b>£m</b>	<b>£m</b>
Minimum Revenue Provision		9.50	9.58	(0.08)
Interest on existing PWLB and bank loans (January 2013 position)		5.65	5.65	-
Rollover £12 million of short-term LA loans taken out for 2012/13 (at an interest rate of 1.00%)	1.	0.12	0.07	0.05
<b>ORIGINAL BUDGET:</b>				
Provision for 20 million of PWLB variable rate loans at 1.40% taken out July 2013 or later.	2.	0.21	-	0.21
Provision for £14 million of PWLB 20 year EIP loans at 3.20% taken out mid-year.		0.23	-	0.23
<b>REVISED FORECAST:</b>				
Additional £17 million of short-term LA loans for 2013/14 (at an interest rate of 0.60%)	2.		0.10	

Provision for £17 million of borrowing from the PWLB – budget covers EIP loan at 3.20% taken out mid-year			0.27	
<b>Total MRP and interest payable</b>		<b>15.71</b>	<b>15.67</b>	<b>(0.04)</b>
<b>Less capitalised interest</b>		<b>(0.30)</b>	<b>(0.30)</b>	<b>-</b>
<b>Forecast budget surplus</b>		<b>15.41</b>	<b>15.37</b>	<b>(0.04)</b>

Notes

Regarding short-term borrowing from other local authorities:

1. The original budget included the risk of a significant increase in rates and the budget was based on an interest rate of 1.00%. The revised budget is based on an interest rate of 0.60%.
2. The original budget also included the risk of reduced availability of short-term LA loans and included provision for variable rate borrowing from the PWLB at an interest rate of 1.40%. This risk is thought to be low and the revised budget includes additional short-term LA borrowing.

**4. Summary of Outturn Position**

- 4.1 The current forecast is for an underspend of £120,000. The underspend comprises:

<b>Summary of Budget underspend</b>	<b>£m</b>
Investment income receivable	0.08
Interest payable on borrowing	0.04
<b>Total underspend</b>	<b>0.12</b>

- 4.2 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. As can be seen from the table at 3.11 capitalised interest of £300,000 has been included in the 2013/14 budget for capital financing costs.
- 4.3 The use of short term loans will continue to be a key part of our treasury management and means we are able to deliver savings against this year's revenue budget for funding the capital programme.