

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 the second estimate of growth in the second quarter being 0.7%. Growth in the foreseeable future is expected to be steady rather than strong.
- The year-on-year Consumer Price Index (CPI) has been fairly stable in recent months (2.7% for May, 2.9% for June and 2.8% in July).
- Recent data suggests a slightly improved economic environment at the aggregate Eurozone level but this could be undone by political risks and uncertainty in Italy, Spain and Portugal (doubts over the longevity of their coalitions) and Germany (due to impending elections in September).
- 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.

2. The Council's Investments

2.1 At 31st July 2013 the council held the following investments:

Investment	Term	Maturity Date	Interest Rate	Amount invested	
				£m	£m
<u>Instant Access Bank Accounts:</u>					
National Westminster	N/A	N/A	0.60%	3.32	
Royal Bank of Scotland	N/A	N/A	0.70%	2.50	5.82
<u>Instant access Money Market Funds:</u>					
Ignis	N/A	N/A	0.43%	3.22	3.22
<u>95 day notice accounts</u>					
Royal Bank of Scotland	N/A	N/A	0.95%	5.00	
Santander	N/A	N/A	1.10%	7.00	12.00
<u>1 month notice account</u>					
Close Bros	N/A	N/A	1.00%	5.00	5.00
<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	
Nationwide	107 days	25/10/13	0.45%	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	22.00

Total			0.81%		48.04
Shaded investments represent term deposits made in the last two months to 31 st July 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:

Counterparty	Maximum maturity period	
	01/04/13	05/07/13
Close Brothers Ltd	100 days	100 days
Santander UK	100 days	100 days
Nat West and RBS	6 mnths	Overnight
Bank of Scotland and Lloyds TSB	6 mnths	6 mnths
Nationwide	12 mnths	12 mnths
Barclays	12 mnths	12 mnths
HSBC and Standard Chartered Bank	12 mnths	12 mnths

- 2.3 The credit rating agency Moody's has placed on review for downgrade the long-term credit ratings of National Westminster Bank and the Royal Bank of Scotland. In accordance with advice from Arlingclose, the council has given notice on its Royal Bank of Scotland 95 day account and will restrict all future investment to instant access accounts.
- 2.4 The council's treasury management advisers, Arlingclose, have issued the following forecast of the Bank Base Rate (forecast issued 30th July 2013). As previously reported, Arlingclose believe that it could be 2016 before the first increase in the Bank Base Rate, a view now supported by the forward guidance issued by the MPC not to raise the rate until the unemployment rate has fallen below 7%.

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

There has been no change to Arlingclose's forecast in recent months.

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

Month	Amount invested		Average rate of interest earned		Amount of interest earned / Forecast £	Budget £	Actual Surplus / Forecast £
	Actual / Forecast £m	Budget £m	Actual / Forecast %	Budget %			
Apr-13	30.41	30	0.82%	0.70%	20,733	17,500	3,233
May-13	50.50	40	0.83%	0.70%	36,206	23,000	13,206
Jun-13	50.00	40	0.83%	0.70%	35,495	23,000	12,495
Jul-13	50.00	40	0.80%	0.70%	35,845	23,000	12,845
					128,279	86,500	41,779
Aug-13	49.00	35	0.80%	0.70%	34,500	20,000	14,500
Sep-13	40.00	35	0.75%	0.70%	25,000	20,000	5,000

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
Original budget and outturn					291,779	199,070	92,709
Budget savings already declared and budgeted income increased					-	60,000	(60,000)
Revised budget and outturn					291,779	259,070	32,709

- 2.6 The interest received in the four months to 31st July 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 notice accounts and term deposits with an increased reliance on short-term borrowing to provide liquidity. This policy is possible because the rates payable on short-term borrowing are lower than the rates earned on the council's investments. However the policy does result in both short-term investment balances and short-term borrowing being relatively high.
- 2.8 Arlingclose provide quarterly benchmarking information for investments, which show that the council is earning an above average rate of return on its investments. The council only uses those counterparties recommended by Arlingclose.

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 interest rates are significantly below levels available from other sources.
- 3.2 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 has a large cost of carry when comparing its fixed interest debt to current investment rates. Short-term borrowing from other local authorities removes this cost of carry and, assuming 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.
- 3.3 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.
- 3.4 At the end of July 2013 short-term borrowing from other local authorities consisted of eight loans totalling £25 million. These loans were for periods ranging from 115 days to 283 days with interest rates varying from 0.36% to 0.44% (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, which also approximates to a 20 year EIP loan (as the average term and average amount outstanding are the same). An EIP 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
Upside risk	+0.50	+0.50	+0.50	+0.50	+0.65	+0.75	+0.85	+1.00	+1.00	+1.00
Central case	3.25	3.25	3.30	3.35	3.40	3.50	3.60	3.70	3.80	3.90
Downside risk	-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 30th July 2013 when the PWLB 10 year maturity loan rate stood at 3.44%. 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 In August the 20 year EIP rate has risen significantly reaching a peak of 3.92% (Standard Rate). In the last few days the interest rate has fallen back slightly and today (28th August) stands at 2.75%.
- 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 recent upward trend 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.

Summary of Borrowing Budget	Budget	Forecast	(Over-spend) / Saving
	£m	£m	£m
Minimum Revenue Provision	9.50	9.58	(0.08)
Interest on existing PWLB and bank loans (January 2013 position)	5.65	5.65	-
<u>Variable rate borrowing for 2013/14</u> Rollover £12 million of short-term LA loans taken out for 2012/13 Budgeted interest rate: 1.00% Forecast rate: 0.60%	0.12	0.07	0.05
<u>Variable rate borrowing for 2013/14</u> Budget: Provision for 20 million of PWLB variable rate loans at 1.40% taken out July 2013 or later. Revised forecast: Additional £17 million of short-term LA loans for 2013/14 (at an interest rate of 0.60%)	0.21	0.10	0.11
<u>Fixed rate borrowing for 2013/14</u> Budget: Provision for £14 million of PWLB 20 year EIP loans at 3.20% taken out mid-year. Revised forecast: £17 million of EIP loans at 3.20% (term may be less than 20 years if PWLB rates remain high)	0.23	0.27	(0.04)
Total MRP and interest payable	15.71	15.67	0.04
Less capitalised interest (see note below)	(0.30)	(0.30)	-
Forecast budget surplus	15.41	15.37	0.04
Reduction in 2013/14 Budget (Budget savings already declared and budget reduced)	(0.04)	-	(0.04)
Revised outturn	15.37	15.37	-

- 3.12 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 above, capitalised interest of £300,000 has been included in the 2013/14 budget for capital financing costs.

4. Summary of Outturn Position

4.1 In view of projected savings, the treasury management budgets have been reduced by £100,000 as part of the recovery plan for addressing shortfalls in adult social care and central procurement targets. The current position is now an underspend of £30,000 calculated as follows:

Summary of Budget underspend	£m
Investment income receivable	0.03
Interest payable on borrowing	-
Total underspend	0.03