

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:

- GDP growth in the first quarter was 0.3% with the second quarter being confirmed at 0.7%. Growth is likely to continue to strengthen with estimates for the third quarter being close to 1%.
- The year-on-year Consumer Price Index (CPI) has been fairly stable in recent months. In August the CPI was 2.7% compared to 2.8% in July.
- Last month's report noted that good economic data from the US led to an expectation that there will be a reduction in the Federal Reserve's bond-buying programme towards the end of the year. However, more recently the Federal Reserve stated that the economic outlook was not considered strong enough to start winding down its monthly \$85 billion bond-buying programme. This announcement on 18th September was partly responsible for a recent fall back in gilt yields and hence PWLB rates.

2. The Council's Investments

2.1 At 31st August 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	0.50%	3.66	
Royal Bank of Scotland	N/A	N/A	0.70%	2.50	6.16
<u>Instant access Money Market Funds:</u>					
Ignis	N/A	N/A	0.43%	3.39	
Prime Rate	N/A	N/A	0.42%	3.28	6.67
<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>					
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	
Lloyds	111 days	25/11/13	0.70%	3.00	
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%		51.83

Shaded investment represents a term deposit made in August 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 from:	
	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 council's treasury management advisers, Arlingclose, have issued the following forecast of the Bank Base Rate (forecast issued 30th September 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	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Upside risk		+0.25	+0.25	+0.25	+0.25	+0.25	+0.50	+0.50	+0.50	+0.75
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

2.4 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	0.85%	0.70%	20,987	17,500	3,487
May-13	50.50	40	0.86%	0.70%	37,098	23,000	14,098
Jun-13	52.57	40	0.84%	0.70%	36,360	23,000	13,360
Jul-13	51.18	40	0.84%	0.70%	36,744	23,000	13,744
Aug-13	49.75	35	0.83%	0.70%	35,156	20,000	15,156
					166,345	106,500	59,845
Sep-13	50.52	35	0.82%	0.70%	34,100	20,000	14,100
Oct-13	45.00	30	0.70%	0.70%	26,250	17,500	8,750
Nov-13	40.00	25	0.70%	0.70%	23,300	14,500	8,800
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	30.00	15	0.60%	0.70%	15,000	8,820	6,180
Mar-14	15.00	15	0.60%	0.70%	8,750	8,750	-
Original budget and outturn					311,745	199,070	112,675
Savings already declared and budget increased					-	60,000	(60,000)
Revised budget and outturn					311,745	259,070	52,675

- 2.5 The interest received in the five months to 31st August 2013 has exceeded budget due to both the amounts invested and the average interest rates achieved being higher than the budgeted amounts.
- 2.6 In recent months interest rates on the council's instant access bank accounts have fallen sharply. In order to maintain investment income the council has been 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.
- 2.7 In October the rates of interest receivable on the council's 95 day notice accounts are also being cut. Interest rate reductions announced so far in 2013 are as follows:

	Rate as at 01/01/13	Date of Change	Revised Rate	Date of Change	Revised Rate
Instant access accounts:					
Bank of Scotland	0.85%			22/04/13	0.40%
Nat West Liquidity	1.10%	12/02/13	0.60%	19/08/13	0.50%
RBS Liquidity	1.10%			09/05/13	0.70%
Santander	0.50%			21/10/13	0.40%
Barclays	0.65%			25/03/13	0.35%
95 day notice accounts:					
Nat West	1.20%	20/05/13	0.80%	22/10/13	0.60%
RBS	0.95%	No change			0.95%
Santander	1.25%			22/10/13	0.55%

- 2.8 The council has given notice on all its 95 day accounts. In the case of National Westminster Bank and Royal Bank of Scotland the council needed to give notice at the beginning of July when Arlingclose reduced the recommended maturity limit to overnight.
- 2.9 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. These short-term 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 currently has a large cost of carry when comparing its fixed interest debt to current investment rates.
- 3.3 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.

- 3.4 The council's Treasury Management Strategy includes various prudential indicators as required by CIPFA's Prudential Code. One of the indicators is the upper limit for variable interest rate exposure. This limit is set with the approval of the council's treasury adviser and in recent years the limit has been set at 25%.
- 3.5 The Treasury Management Strategy Statement (TMSS) for 2013/14 forecast that further borrowing of £34 million would be needed for 2013/14 and the borrowing budget was based on this figure. Even if the whole of this years borrowing was short-term the would still be within our approved limits for variable borrowing.
- 3.6 If the council has variable rate debt at the same level as its variable rate investments, it is deemed to have no variable rate exposure.
- 3.7 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.
- 3.8 At the end of August 2013 short-term borrowing from other local authorities consisted of ten loans totalling £34 million. These loans were for periods ranging from 58 days to 364 days with interest rates varying from 0.33% to 0.44% and averaging 0.38% (including brokers commission).

Long-term borrowing

- 3.9 No long-term loans have been taken out in the period to date.
- 3.10 In mid-September PWLB rates peaked but they have since fallen back. For example on 11th September the 20 year EIP rate reached a peak of 4.03% but today (30th September) the "Standard Rate" stands at 3.69%.
- 3.11 This fall back in rates is partly due to the US Federal Reserve announcing a continuation of its bond-buying programme, at least for the time being, when the market was expecting an announcement to be made regarding reducing the monetary stimulus. Also, as noted in the last report, Arlingclose believed that the earlier climb in rates was overdone considering the global economic outlook.
- 3.12 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 (forecast issued 30th September). (An EIP loan is repaid in equal instalments every six months over the period of the loan and so the average term and average amount outstanding for an EIP loan is the same as for a maturity loan of half the duration.)

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Upside risk	+0.50	+0.50	+0.50	+0.65	+0.75	+0.85	+1.00	+1.00	+1.00	+1.00
Central case	3.55	3.60	3.65	3.70	3.75	3.80	3.85	3.90	4.00	4.10
Downside risk	-0.50	-0.50	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.65	-0.75

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.

Arlingclose's forecast is unchanged from that issued the previous month..

- 3.13 As noted in the previous report, the “central case” of Arlingclose’s forecast shows that they still believe that current rates are over-inflated, however, the upside and downside risk margins reflect the difficulty in making the forecast. Arlingclose expect rates to be volatile.
- 3.14 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 current position is summarised below.

Summary of Borrowing Budget	Revised Budget	Forecast	(Over-spend) / Saving
	£m	£m	£m
Minimum Revenue Provision	9.58	9.58	-
Interest on existing PWLB and bank loans (January 2013 position)	5.65	5.65	-
Variable rate borrowing for 2013/14 Rollover £12 million of short-term LA loans taken out for 2012/13 at an interest rate of 0.60%	0.07	0.07	-
Additional £17 million of short-term LA loans for 2013/14 (at an interest rate of 0.60%)	0.10	0.10	-
Fixed rate borrowing for 2013/14 Budget: £17 million of EIP loans at 3.20% taken out mid-year	0.27	0.27	-
Slippage in capital programme Slippage of £7m of capital spend compared to the specific schemes included in original budget (£3m relating to Broadband)	-	(0.08)	0.08
Reduction in budget contributions from service areas	(0.13)	-	(0.13)
Less capitalised interest (see note below)	(0.30)	(0.30)	-
Forecast overspend compared to budget	15.24	15.29	(0.05)

- 3.15 The above reflects the position regarding the current approved capital programme. However, the capital programme for the current year is being reviewed and may be amended to incorporate slippage and possibly new capital schemes.
- 3.16 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 The current net treasury position, compared to budget, is estimated to be break-even with an overspend on the borrowing side being offset by a surplus on investment income.

Summary of Budget underspend	£m
Investment income receivable	0.05
Interest payable on borrowing	(0.05)
Total (overspend) / savings	0.00