Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report 2013/14

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WHAT BENEFITS WILL THESE PROPOSALS BRING TO COPELAND RESIDENTS?

WHY HAS THIS REPORT COME TO THE EXECUTIVE?
This mid-year report has been prepared and is reported in compliance with the Chartered Institute of Public finance Accountancy's (CIPFA) Code of Practice on Treasury Management which was adopted by this Authority on 14 December 2009. The report briefly covers the following:

- An economic update for the 2013/14 financial year to 30 September 2013 (paragraph 2);
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (paragraph 3);
- The Council's capital expenditure (prudential indicators – paragraph 4);
- A review of the Council's investment portfolio for 2013/14 (paragraph 5);
- A review of the Council's borrowing strategy for 2013/14 (paragraph 5);
- A review of any debt rescheduling undertaken during 2013/14 (not applicable);
- A review of compliance with Treasury and Limits for 2013/14 (prudential indicators - paragraph 4)

Recommendations:
Executive is asked to:
1. Note the Mid-Year Review
2. Note the forecast investment income currently in line with budget, subject to current economic conditions prevailing to year end.

1. INTRODUCTION

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2. ECONOMIC UPDATE

2.1 Economic Performance to date

During 2013/14 economic indicators suggested that the economy is recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion the economy grew 0.7% in Q2. There have been signs of renewed vigour in household spending in the summer, with a further pick-up in retail sales, mortgages, house prices and new car registrations.

The strengthening in economic growth appears to have supported the labour market, with employment rising at a modest pace and strong enough to reduce the level of unemployment further. Pay growth also rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.0% year on year, well below the rate of inflation at 2.7% in August, causing continuing pressure on household's disposable income.

The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling further to new lows. Together with the Government's Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks have risen as have house prices, although they are still well down from the boom years pre 2008.

Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 started to come down, but only slowly, as Government expenditure cuts took effect and economic growth started to show through in a small increase in tax receipts. The 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan, and monetary policy was unchanged in advance of the new Bank of England Governor, Mark Carney, arriving. Bank Rate remained at 0.5% and quantitative easing also stayed at £375bn. In August, the Monetary Policy Committee (MPC) provided forward guidance that Bank Rate is unlikely to change until unemployment first falls to 7%, which was not expected until mid 2016. However, 7% is only a point at which the MPC will review Bank Rate, not necessarily take action to change it. The three month to July average rate was 7.7%.

CPI inflation (MPC target of 2.0%), fell marginally from a peak of 2.9% in June to 2.7% in August. The Bank of England expects inflation to fall back to 2.0% in 2015.

Financial markets sold off sharply following comments from Ben Bernanke (the Fed chairman) in June that suggested the Fed. may 'taper' its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK. Equity prices fell initially too, as Fed. purchasing of bonds has served to underpin investor moves into equities out of low yielding bonds. However, as the market moves to realign its expectations, bond yields and equities are likely to rise further in expectation of a continuing economic recovery. Increases in payroll figures have shown further improvement, helping to pull the unemployment rate down from a high of 8.1% to 7.3%, and continuing house price rises have helped more households to escape from negative equity. In September, the Fed. surprised financial markets by not starting tapering as it felt the run of economic data in recent months had been too weak to warrant taking early action. Bond yields fell sharply as a result, though it still only remains a matter of time until tapering does start.

Tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a renewed flare-up. Economic survey data improved consistently over the first half of the year, pointing to a return to growth in Q2, so ending six quarters of Eurozone recession.

2.2 Outlook for the next six months of 2013/14

The overall balance of risks to economic recovery in the UK is now weighted to the upside after five months of robust good news on the economy. However, only time will tell just how long this period of strong economic growth will last, and it remains exposed to vulnerabilities in a number of key areas. The longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Near-term, there is some residual risk of further QE if there is a dip in strong growth or if the MPC were to decide to take action to combat the market's expectations of an early first increase in Bank Rate. If the MPC does takes action to do more QE in order to reverse the rapid increase in market rates, especially in gilt yields and interest rates up to 10 years, such action could cause gilt yields and PWLB rates over the next year or two to significantly undershoot the forecasts in the table below. The tension in the US over passing a Federal budget for the new financial year starting on 1 October and raising the debt ceiling in mid October could also see bond yields temporarily dip until agreement is reached between the opposing Republican and Democrat sides. Conversely, the eventual start of tapering by the Fed. will cause bond yields to rise.

The general outlook for the UK economy is that economic performance should improve from a low level, but is unlikely to be strong. Growth (GDP) should be positive in quarter 3 of 2012, breaking the recession, but remain low or negative in future quarters. The full impact of the Comprehensive Spending Review is yet to be felt, which will depress growth, although employment and unemployment data have been better than expectations. Whilst inflation has fallen, the consumer remains in an indebted position, with real incomes falling and concerns over job security. Judged against other countries our performance is good, but our key risks surround events outside the UK's control, particularly the Euro-zone debt crisis and forthcoming fiscal tightening in the US. Against this backdrop UK monetary policy will remain loose (a low Bank Rate and further Quantitative Easing), in the hope that the world economy (particularly the Euro-zone) begins to recover and have a positive effect on the UK.

2.3 Capita Asset Services interest rate forecast (for PWLB certainty rates)

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
5yr PWLB rate	2.50%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
10yr PWLB rate	3.70%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
25yr PWLB rate	4.40%	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%
50yr PWLB rate	4.50%	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.30%

Expectations for the first change in Bank Rate in the UK are now dependent on how to forecast when unemployment is likely to fall to 7%. Financial markets have taken a very contrary view to the MPC and have aggressively raised short term interest rates and gilt yields due to their view that the strength of economic recovery is now so rapid that unemployment will fall much faster than the Bank of England forecasts. They therefore expect the first increase in Bank Rate to be in quarter 4 of 2014. There is much latitude to disagree with this view as the economic downturn since 2008 was remarkable for the way in which unemployment did not rise to anywhere near the extent likely, unlike in previous recessions. This meant that labour was retained, productivity fell and now, as the MPC expects, there is major potential for unemployment to fall only slowly as existing labour levels are worked more intensively and productivity rises back up again. The size of the work force is also expected to increase relatively rapidly and there are many currently self-employed or part time employed workers who are seeking full time employment. Capita Asset Services take the view that the unemployment rate is not likely to come down as quickly as the financial markets are currently expecting and that the MPC view is more realistic. The prospects for any increase in Bank Rate before 2016 are therefore seen as being limited. However, some forecasters are forecasting that even the Bank of England forecast is too optimistic as to when the 7% level will be reached and so do not expect the first increase in Bank Rate until spring 2017.

3. Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2013/14 was approved by this Council on 21 February 2013. There are no policy changes to the TMSS; the details in this report update the position in light of the updated economic position and budgetary changes already approved.

4. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

4.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget set in February 2012.

Capital Expenditure	2013/14 Original Estimate £000's	Current spend as at 30 September 2013 £000's	2013/14 Revised forecast spend £000's
Total	1,600	376	1,739

As detailed in the table above, a gross capital programme budget for 2013/14 of £1,599,524 was approved by Council on 21 February 2013. This was later increased for various reasons as identified in the table below, to give a revised gross capital expenditure budget of £3,872,464.

CAPITAL PROGRAMME BUDGET 2013/14			
	£	£	*CUMULATIVE*
Original Budget approved at Council 21/02/13		**1,599,524**	1,599,524
Approved amendments to budget:			
Addition: Approved at Q3 12/13 Capital Report P10 EXE 12/03/13 - £12k from eventual sale of Kells Plots for Kells Drainage	12,000		1,611,524
Addition: Approved at Outturn 12/13 EXE 28/05/13 - Slippage from 2012/13	639,845		2,251,369
Addition: Approved at Outturn 12/13 EXE 28/05/13 - £27,452 to re-instate Millom Cemetery from £121,764 to £149,216	27,452		2,278,821
Addition: Approved External Funding St Bees Play in addition to £40k CBC EXE 18/12/12 - £30,250 CCF, £60k WREN, £5k St Bees Group & £3k additional St Bees Group	89,367		2,368,188
Addition: Approved THI External Funding in addition to CBC £250k EXE 28/05/13 - £394.6k BEC, £659.2k HLF	1,053,800		3,421,988
Additon: Approval for Copeland Pool: receipt and spend of match funding to CBC £263k Capital EXE 12/09/13 £150k Sport England, £300k CCF	450,476		3,872,464
Current Budget		**3,872,464**	

A detailed Capital Programme 2013/14 Budget Monitoring Report as at Quarter 2 is presented elsewhere on this agenda.

4.2 Changes to the Financing of the Capital Programme

The table overleaf draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported (i.e. paid for in year of spend) and unsupported (not paid for in year of spend) elements of the capital programme, and the expected financing arrangements of this capital expenditure. Any borrowing element in the table would increase the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this would be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). Any direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2013/14 Original Estimate £000's	Current spend as at 30 September 2013 £000's	2013/14 Revised forecast spend £000's
Supported	1,600	376	1,739
Unsupported	0	0	0
Total spend	**1,600**	**376**	**1,739**
Financed by:			
Useable Capital receipts	1,339	85	949
Other Reserves & Contributions	0	0	0
External Funding	261	291	790
Total financing	**1,600**	**376**	**1,739**
Borrowing need	**0**	**0**	**0**

4.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table at 4.5 below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the **Operational Boundary.**

4.4 Prudential Indicator – Capital Financing Requirement (CFR) (Underlying need to borrow)

We are on target to achieve the amended forecast Capital Financing Requirement as outlined in the table below.

4.5 Prudential Indicator – External Debt / the Operational Boundary

	2013/14 Original* Estimate £000's	2013/14 Revised** Estimate £000's
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	8,452	7,945
Net movement in CFR	**0**	**(507)**
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	5,000	5,000
Other long term liabilities***	6,380	5,873
Total debt 31 March	**11,380**	**10,873**

** This is the balances detailed in the 12/13 financial statements*
***Revised as at mid-year point - 30 September 2013*
****On balance sheet PFI schemes and finance leases etc.*

4.6 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent and necessary.

Limits to Borrowing Activity	2013/14 Amended Estimate £000's	2013/14 Revised Estimate £000's
Gross borrowing	5,000	5,000
Plus other long term liabilities*	6,380	5,873
Less investments	(18,452)	(18,482)
* **Net borrowing**	**(7,072)**	**(7,609)**
* **CFR (year-end position)**	**8,452**	**7,945**

**Includes on balance sheet PFI schemes and finance leases.*

The Head of Corporate Resources reports that no difficulties are envisaged for the current year in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the **Authorised Limit** which represents the limit beyond which borrowing is prohibited. This limit needs to be set and revised by Members. It reflects the level of borrowing which, while not desirable, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	**2013/14 Original Indicator**	**2013/14 Revised Indicator**
Borrowing	9,000	9,000
Other long term liabilities*	8,000	8,000
Total	17,000	17,000

**Includes on balance sheet PFI schemes and finance leases.*

5 Investment Portfolio 2013/14

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades, as rates are very low and in line with the 0.5% Bank Rate. Indeed, the introduction of the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment, investment returns are likely to remain low.

The Treasury Management budget was set by Council alongside other revenue budgets on 21 February 2013. The budget was prepared assuming that interest rates would remain at the current low level for the foreseeable future however, as expected in previous years, there was still a possibility that interest rates could rise. With this expectation, the budget for Treasury Management interest was set at £202,822 incorporating a reduction/pressure of £25,000 to reflect the Councils anticipated capacity to generate income from possible future investments, given the market conditions and forecasts at the time.

However, the full year forecast for investment interest at 30 September 2013 is expected to be on budget at £203k if current market conditions prevail to the end of the financial year.

This is shown in the table below:

Anticipated Investment Return 2013/14:

Budget £	**Received to Date**	**Interest on current outstanding investments**	**Forecast of expected investments to 31/03/14**	**Total Forecast position as at 31/03/14**	**Variance £**
202,822	82,013	68,794	52,133	202,940	(118)

The Council held £37m of investments as at 30 September 2013, of this £29.6m were held in instant access Call accounts/Money Market Funds (and therefore would be deemed as cash equivalent within the year end accounts) the remainder being held in fixed term deposits for period not exceeding 1 year. The average investment portfolio yield for the first six months of the year is 0.44% against current base rate of 0.5%.

The Head of Corporate Resources confirms that the approved limits within the Annual Investment Strategy were not breached with the exception of one occasion during the first six months of 2013/14. The strategy breach was related to a substantial NNDR receipt being credited to our account after the money markets had closed for daily dealing. With no alternative we placed the funds within our own bank in a Special Interest Bearing Account (which is a higher rated account with the same security) overnight until it could then be invested the following day. Although there was no increased security risk in placing the money with our own Bank this action subsequently resulted in an overnight breach of our self-imposed monetary limits for investments with our own banker which is restricted within the Treasury Management Strategy Statement to £10k. The Section 151 Officer authorised this action. The funds were then invested as originally intended the following day once the money markets were open. Measures are currently being taken to ensure substantial receipts of this nature are cleared prior to the 1pm dealing deadlines wherever possible.

A full list of investments held as at 30 September 2013 is presented at Appendix A.

5.1 Investment Counterparty criteria

The counterparty criteria is under regular review, however no further amendments to the Treasury Management and Investment Strategies are sought at this time. The revised draft Treasury Management and Investment Strategy for 2014/15 will be presented and approved prior to the start of the new financial year.

5.2 Borrowing

The Council's capital financing requirement (CFR) for 2013/14 is £7.8m. The CFR denotes the Council's underlying need to borrow for capital purposes. The Council's underlying need to borrow is supported by finance leases for both the Copeland Centre (PFI) and vehicles.

The Council's debt portfolio contains one remaining Market Loan of £5 million. We continually assess the position of this loan with our Treasury Consultants, Sector, to see whether we are securing the best terms for the Council. At the current time, the advice is to leave this loan in its present form, as the penalty for repaying early would be prohibitive.

In the event that borrowing is necessary, the Head of Corporate Resources, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time and taking into account contemporaneous forecasts. Executive agreement would be sought and if necessary, an amendment to the Treasury Management Strategy would be sought from Council.

The general trend has been an increase in interest rates during the six months, across all maturity bands.

6. STATUTORY OFFICER COMMENTS

The Monitoring Officer's comments are: No further comments

The Section 151 Officer's comments are: Contained in the report.

EIA Comments: EIA was conducted as part of the budget setting process.

Policy Framework: The Council's financial policies and procedures form an integral part of the Council's corporate policy framework.

Other consultee comments, if any:

7. RESOURCE REQUIREMENTS

8. HOW WILL THE PROPOSALS BE PROJECT MANAGED AND HOW ARE THE RISKS GOING TO BE MANAGED?

The Treasury Management function is continually monitored and is reported to Executive throughout the year. It also forms part of the revenue monitoring report distributed to Heads of Service on a monthly basis. The principles set out in the Treasury Management Strategy ensure that we have a balance between security and liquidity of funds and the yield achieved, with security being the principle concern particularly in the current economic climate.

9. WHAT MEASURABLE OUTCOMES OR OUTPUTS WILL ARISE FROM THIS REPORT?

As stated above the position will continue to be closely monitored and the Treasury Management Strategy 2014/15 will and presented to Full Council for approval prior to the start of the new financial year.

List of Appendices

Appendix A: Temporary investments as at 30 September 2013.

List of Background Documents:

Treasury Management Strategy 2013/14 incorporating the Annual Investment Strategy 2013/14 & Minimum Revenue Provision Statement 2013/14, Capital Programme 13/14 Budget Monitoring Report (Quarter 2).

Appendix A

TEMPORARY INVESTMENTS AS AT 30 SEPTEMBER 2013

	AMOUNT	PERIOD OF LOAN	VALUE DATE	MATURITY DATE	RATE	BASE RATE
RBS CALL	7,450,000	CALL			0.70%	
RBS MMF	2,376,000	CALL			0.33%	
IGNIS MMF	4,950,000	CALL			0.38%	
BLACKROCK MMF	4,950,000	CALL			0.29%	
INSIGHT MMF	4,950,000	CALL			0.34%	
LLOYDS DEPOSIT	7,450,000	364 DAYS	21/05/2013	20/05/2014	1.05%	
FEDERATED INVESTORS MMF	4,950,000	CALL			0.37%	
TOTAL	**37,076,000**					0.50%

SUMMARY

	BALANCE	***LIMIT***		***AVAILABLE***
DMADF	0	Unlimited		
BANK OF SCOTLAND/LLOYDS	7,450,000	10,000,000	*	2,550,000
RBS MMF	2,376,000	5,000,000		2,624,000
RBS	7,450,000	10,000,000	*	2,550,000
IGNIS MMF	4,950,000	5,000,000		50,000
INSIGHT MMF	4,950,000	5,000,000		50,000
BLACKROCK MMF	4,950,000	5,000,000		50,000
FEDERATED INVESTORS MMF	4,950,000	5,000,000		50,000
LGIM	0	5,000,000		5,000,000
	37,076,000	**50,000,000**		**7,874,000**

* Investment limit of £7.5m, how ever ulitmate limit of upto £10m w ith prior approval of S151 and for short term investments only.