CAPITA

Asset Services

Treasury solutions

Treasury Management Update

Quarter Ended 30th June 2014

FAR COMMITTEE (18.9.14)

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The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code.

1. Economic Background

- After strong UK GDP growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, and 0.8% in Q1 2014, it appears very likely that strong growth will continue into 2014 as forward surveys are very encouraging. There are also positive indications that recovery is starting to broaden away from reliance on consumer spending and the housing market into construction, manufacturing, business investment and exporting. This strong growth has resulted in unemployment falling much faster through the threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, now broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. Accordingly, markets are expecting a first increase around the end of 2014.
- Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly 1%. The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed in this quarter.
- In June, the Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2014. Asset purchases have now fallen from $85bn to $35bn and are expected to stop by Q3 201, providing strong economic growth continues this year. First quarter GDP figures were depressed by exceptionally bad winter weather, but growth rates since then look as if they are recovering well.
- The Eurozone is facing an increasing threat from deflation. In May, the inflation rate fell further, to reach 0.5%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June to loosen monetary policy in order to promote growth.

2. Interest Rate Forecast

Capita Asset Services rate forecast:

	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Bank rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.40%	4.40%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%
50yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%

Capita Asset Services undertook a review of its interest rate forecasts in May, after the Bank of England’s Inflation Report. However, more recent developments to the Bank of England’s forward guidance have necessitated a second updating in this quarter carried out on 30 June. This latest forecast now includes a first increase in Bank Rate in quarter 1 of 2015 (previously quarter 4 of 2015).

SUMMARY OUTLOOK

Until 2013, the economic recovery in the UK since 2008 had been the worst and slowest recovery in recent history. However, growth rebounded during 2013 and the first quarter of 2014 to surpass all expectations, propelled by recovery in consumer spending and the housing market. Forward surveys are currently very positive in indicating that growth prospects are also strong for the rest of 2014, not only in the UK economy as a whole, but in all three main sectors, services, manufacturing and construction. This is very encouraging as there does need to be a significant rebalancing of the economy away from consumer spending to construction, manufacturing, business investment and exporting in order for this start to recovery to become more firmly established. One drag on the economy has been that wage inflation has been significantly below CPI inflation, so disposable income and living standards were being eroded, (although income tax cuts had ameliorated this to some extent). However, recent falls in inflation have created the potential for the narrowing of this gap and it could narrow further during this year, especially if there is also a recovery in growth in labour productivity (leading to increases in pay rates). With regard to the US, the main world economy, it faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although labour force participation rates remain lower than ideal.

As for the Eurozone, concerns subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2014/15, which includes the Annual Investment Strategy, was approved by the Council on 13th February 2014. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield.

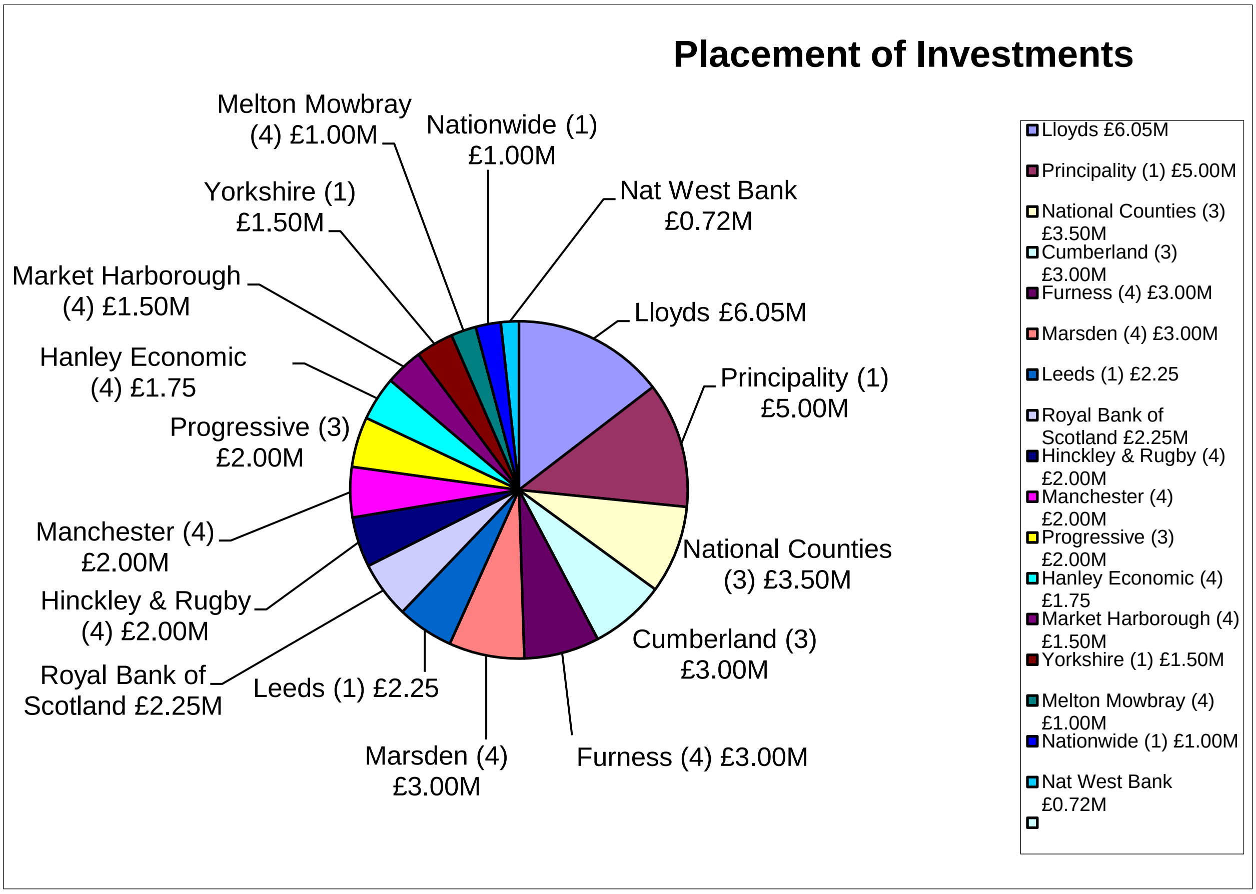
The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in higher rates in periods up to 24 months.

Investments as at 30 June 2014

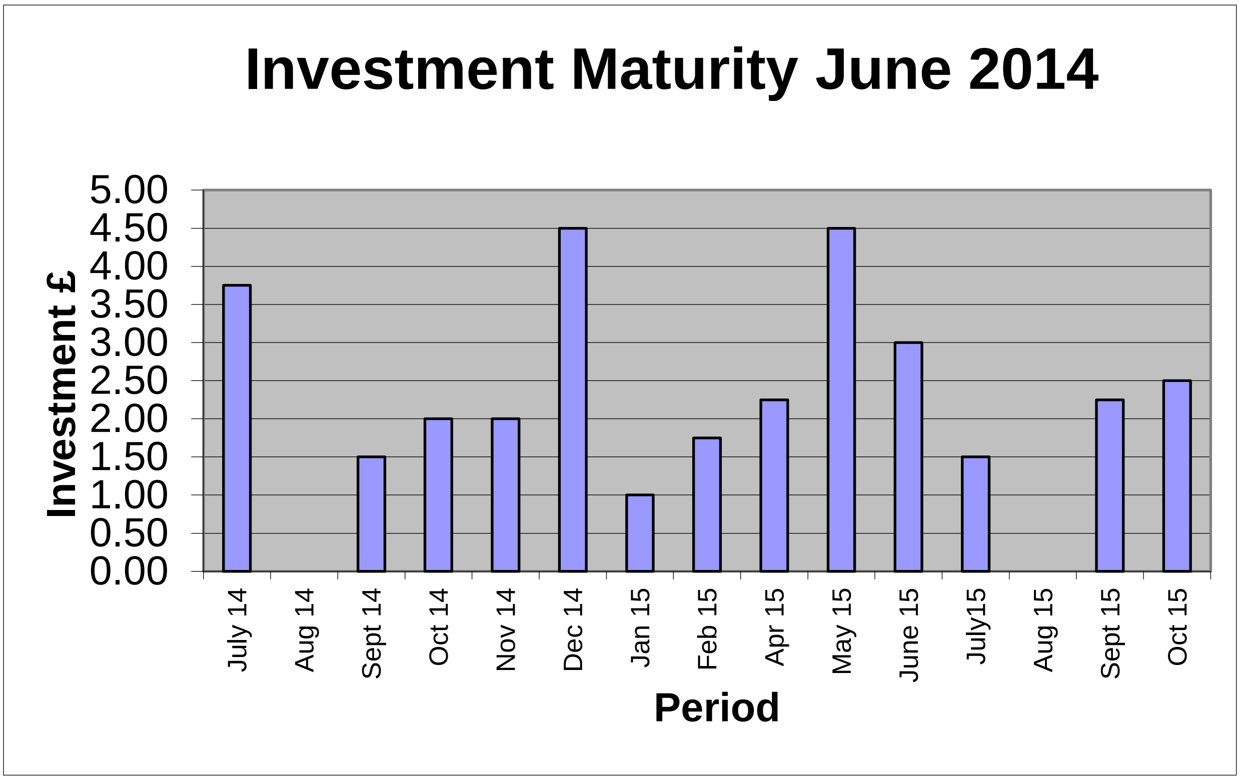
	Amount £	**Average Interest Rate %**
Managed By NHDC		
Lloyds Bank	4,296,835	0.4
Nat West Bank	715,000	0.25
NHDC Total	**5,011,835**	**0.39**
Managed by Sterling		
Banks		
Building Societies	16,500,000	1.37
Sterling Total	**16,500,000**	**1.37**
Managed by Tradition		
Banks	4,000,000	2.17
Building Societies	16,000000	1.57
Tradition Total	**20,000,000**	**1.72**
TOTAL	**41,511,835**	**1.57**

The pie chart below shows the spread of investment balances as at 30 June 2014. The figures shown are in millions whilst the figure in brackets denotes the value of the building societies total assets:

(1) Building Societies with Assets over £4.5bn
(2) Building Societies with Assets between £2.5bn - £4.5bn
(3) Building Societies with Assets between £1.0bn - £2.5bn
(4) Building Societies with Assets between £0.3bn - £1.0bn



The chart below shows the Council's investment maturity profile. (This does not include the £0.72M held in the Nat West Liquidity account or £4.3M of the £6.05M held in the Lloyds current account which can be called back on any day).

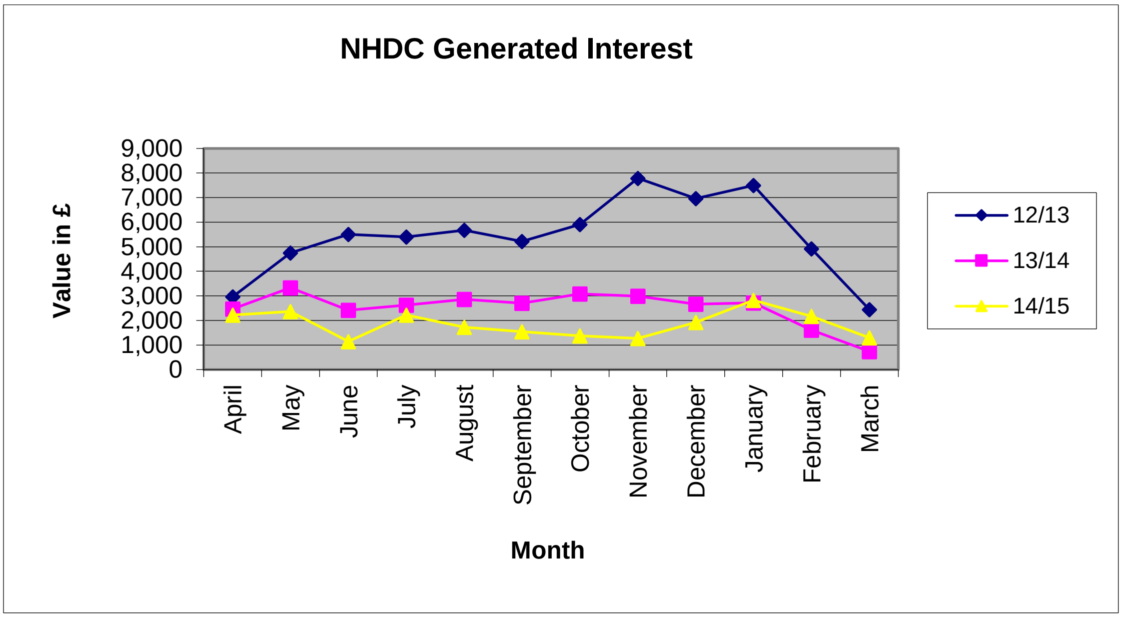


Investment rates available in the market have been broadly stable during the quarter and have continued at historically low levels as a result of the ultra-low Bank Rate and other extraordinary measures such as the Funding for Lending Scheme. The average level of funds available for investment purposes during the quarter was £6.14M. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. At the 30th June the Council held £36.5M core cash balances for investment purposes (i.e. funds available for more than one year). This could reduce to £31.5M during the year if expected capital receipts do not materialise and investments are taken back to fund the Capital programme.

Investment performance for quarter ended 30th June 2014

The Council's budgeted investment return for 2014/15 is £0.48M, and performance for the year to date is in line with the budget £0.007M above budget, giving a new budget of £0.49M.

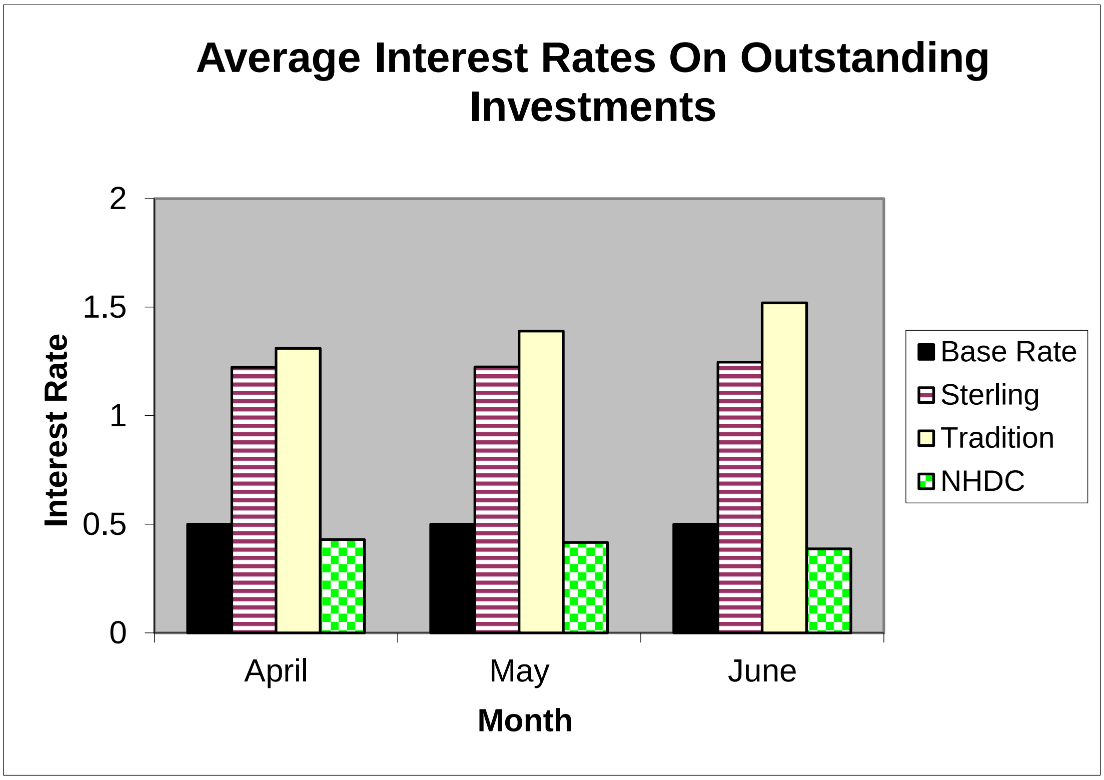
The graph below shows the level of interest expected to be generated from the cash available in-house over the year which is maintained to ensure adequate cashflow. Cash balances have historically reduced over January to March each year as there were no Council tax receipts in February and March. Receipts are now spread more evenly as many residents are choosing to pay council tax over 12 months.



The table below shows the average rates achieved on investments made during the first quarter.

	Ave Interest Rate on Deals
	%
NHDC	0.42
Sterling	0.97
Tradition	1.32

Base rate started the year at 0.5% and remained constant through the first three months. The graph below shows the average rate of interest on outstanding Investments.



As can be seen from the graph, the average rate of interest on outstanding investments for NHDC is consistently lower than that of the Cash Managers. This is because the investments made by NHDC during the year are to meet cash flow requirements and are therefore made for short periods. At present, rates in the shorter periods are lower than the longer periods. The Cash Managers have more long term investments and the turnover of investments is small in comparison to NHDC.

4. New Borrowing

A temporary loan of £0.57M was taken out on 14th April for one day to cover a shortfall in cashflow with a rate of 0.61%. The shortfall occurred as £8.7M of expenditure (County Precept, Benefits and Salaries) was paid on the 14th whilst £4.2M of income (Housing Subsidy Grant and Council Tax) was not received until the 15th. Interest paid on this loan was £9.53.

The table below shows the current borrowing rates available from the Public Works Loans Board.

PWLB certainty rates, quarter ended 30th June 2014

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.20%	2.50%	3.42%	4.12%	4.08%
Date	08/04/2014	14/04/2014	16/05/2014	16/05/2014	16/05/2014
High	1.47%	2.85%	3.66%	4.30%	4.28%
Date	17/06/2014	20/06/2014	20/06/2014	03/04/2014	02/04/2014
Average	1.29%	2.66%	3.56%	4.22%	4.18%

Loans Outstanding as at 30 June 2014

	Amount £	Average Interest Rate %	Cumulative Rate %
Public Works Loans Board	659,478	8.39	8.85
Lender Option Borrower Option	1,000,000	10.13	10.10
Temporary Loans 364 Days and	-	-	
	1,659,478	9.44	8.53

The Council has reduced the overall debt liability by repaying £1.97M of external debt in the first quarter. This was the temporary loan taken in April and a temporary loan taken in March to cover a short fall in cashflow for 20 days. The total of loan repayments during the year will be £2,057,387. This is made up of the temporary loans of £1.97M and PWLB loans reaching maturity.

5. Debt Rescheduling

No debt rescheduling was undertaken during the quarter.

6. Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved TMSS.

During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices with the exception of exceeding the £9M investment limit with Lloyds bank. This was due to maintaining a high level of balance on the Council's current account rather than placing term investments with Lloyds. The total value of term investments with Lloyds bank is £1.75M, well within the £9M limit. The prudential and treasury indicators are shown below.

Prudential Indicator	2014/15 Budget £'000	As at 30 June 2014 £'000
Capital expenditure	10,871	329
In year borrowing requirement	0	0
Authorised limit for external debt	8,000	1,659
Operational boundary for external debt	6,000	1,659
Gross borrowing	4,659	1,659
Investments	(42,500)Ave	(41,512)
Net borrowing	(37,841)	(39,853)*
Capital Financing Requirement (CFR)	(23,340)	(23,340)
Limit of fixed interest rates based on investment	70%-100%	91%
Limit of variable interest rates based on investments	0%-30%	9%
Principal sums invested > 364 days	20,000 Max	9,250
Maturity structure of borrowing limits		
Under 12 months	87	87
12 months to 2 years	57	57
2 years to 5 years	1,076	1,076
5 years to 10 years	92	92
10 years and above	347	347

* The Net borrowing (outstanding borrowing less cash investments) is a credit of £40M as at the end of June 2014 because the Council has more cash investments than borrowing. As a result the Capital Financing Requirement is negative.