POLICY AND RESOURCES SCRUTINY COMMITTEE - 11TH NOVEMBER 2014

SUBJECT: TREASURY MANAGEMENT AND CAPITAL FINANCING PRUDENTIAL INDICATORS MONITORING REPORT (1ST APRIL 2014 TO 30TH SEPTEMBER 2014)

REPORT BY: ACTING DIRECTOR OF CORPORATE SERVICES AND SECTION 151 OFFICER

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1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for the period 1st April 2014 to 30th September 2014.

1.2 To review the Treasury Management Strategy for 2014/2015 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

2.1 The Code of Practice on Treasury Management in the Public Services 2009, which was adopted by the Council on 12th October 2010, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). TMP6 (Reporting Requirements and Management Information Arrangements) provides for the submission of monitoring reports to the appropriate Committee on a quarterly basis.

2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

2.3 The Authority's Annual Investment Strategy and Capital Financing Prudential Indicators for 2014/2015 were approved by Council on 26th February 2014.

3. LINKS TO STRATEGY

3.1 Treasury Management Strategy 2014/2015 as agreed by Council on 26th February 2014.

4. THE REPORT

4.1 Treasury Management

4.1.1 Loans administered by Caerphilly CBC

Due to the current level of interest rates, the difference between long-term borrowing rates and short-term investment rates has given rise to a cost of carry risk. The current policy of internal borrowing is no longer sustainable, but where prudent the policy of internal borrowing will be utilised. A review of the balance sheet for 2013/2014 shows that the level of internal borrowing was not as high as anticipated. At 31st March 2014 the internal borrowing position was £39m.

The Annual Treasury Management Strategy approved by Council in February 2014 indicated that there would be a need to borrow £19.8m in 2014/2015 to part fund the Capital Programme. £7.8m of this total would be met through supported borrowing approvals (inclusive of £2.8m for the Highways LGBI capital works), £4m for Bargoed Cinema and £8m for WHQS (General Fund contribution).

As at the 30th September 2014 no new loans were raised. Furthermore, the General Fund will not be able to contribute £8m of new borrowings towards the WHQS programme following advice from Welsh Government.

Borrowing rates during the period covered by the report have remained flat and broadly in line with the forecasted rates as reported in the 2014/15 Treasury Management Strategy, but lower than the budget rate. There were periods when rates had fallen below 4% for long-term loans. Economic recovery continues to remain fragile and slow. Falling inflation is considered to be a threat towards UK economic recovery, whilst the debate on an interest rate rise has started.

During the period covered by this report, PWLB loans to the value of £645k were repaid on maturity. Such loans had an average interest rate of 7.06%. £30k of the WRU Loan was also repaid.

Total debt outstanding as at 30th September 2014 was £181.56m and comprised of £141.29m PWLB loans, £40m market loans, and £270k WRU loan.

The Authority's debt portfolio variable interest rate proportion at 30th September 2013 stood at 11.01%, which is within the Council's determination of 50%. The variable debt relates to two market loans with a combined value of £20m.

4.1.2 Rescheduling

The Annual Strategy allows for the utilisation of debt rescheduling to provide for both in year and future year savings and additional revenue resources. No rescheduling opportunities presented themselves during the period covered by this report.

4.1.3 Loans administered by Newport City Council

These are non-PWLB loans held by the former Gwent County Council and administered by Newport City Council. All loans have been repaid and the last repayment was in January 2014.

4.1.4 Long-Term Investments

The Council no longer holds any long-term investments.

4.1.5 Short-Term Investments (Deposits) – Up to 364 Days

The value of short-term deposits at 30th September 2014 was £94.21m and is made up of a spread of periods up to a maximum of three months. The average rate for these deposits was 0.26%, which compares favourably with the Debt Management Account Deposit Facility (DMADF) deposit rate of 0.25%, and is above the target rate, as detailed in the Annual Treasury Management Strategy report to Council, of 0.25%. The low returns reflect the Council's current risk sentiment as well as current interest rates. The portfolio as at 30th September 2013 comprised of £40.87m deposited with Local Authorities and £53.34m deposited in the DMADF.

4.1.6 Economic Outlook

Members will be aware from news reports that the global economic recovery continues to remain fragile, with weak growth reported across the developed economies. Inflation continues to fall and there is fear of deflation in the UK. Eurozone inflation continued to fall towards zero. The UK labour market continued to improve, with strong employment gains and the headline unemployment rate falling to 6.2%. However, earnings growth remained very weak. The growth in employment was masked by a large number of zero hour contracts and involuntary part-time working.

The Bank of England has maintained the Bank Rate at 0.50% and asset purchases at £375bn. However, the European Central Bank lowered its official benchmark interest rate from 0.15% to 0.05%. The rate it pays on commercial bank balances held with it was also cut further into negative territory from -0.1% to -0.2% and the Marginal Lending Facility rate cut further to 0.3%. There was no change from the US Federal Reserve as the central bank kept policy on its current track with a reduction in asset purchases by $10 billion per month. Asset purchases are expected to end by October 2014, expectations therefore turned towards the timing of rate increases. The US economy rebounded strongly in Q2 with annualised growth of 4.6%.

Gilt yields have continued to decline and hit a financial year low at the end of August, before ticking upwards in the run up to the Scottish referendum. What has driven yields lower is a combination of factors but the primary drivers have been the escalation of geo-political risk within the Middle East and Ukraine alongside the slide towards deflation within the Eurozone (EZ).

Taking this volatility into consideration, the current Treasury Management Strategy remains unchanged, and attitude to risk continues to be one of caution when managing surplus cash. Surplus cash is being deposited with either the DMADF or other Local Authorities, albeit at unfavourable rates when compared to the market. This will be subject to a further report to the Scrutiny Committee in January 2015.

4.1.7 Bank Tender

The Authority has extended the current short-term bank contract with Barclays up until 31st January 2015. It is expected that a long-term contract with a suitable bank will be in place by then following the conclusion of the current bank tender exercise that is expected to conclude in December 2014.

4.1.8 Treasury Management Advisors Contract

The Authority is currently advised by Arlingclose Limited. The contract commenced in April 2014.

4.2 Prudential Indicators

4.2.1 Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the Authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice, and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in Appendix 1 are set at a level in excess of the CFR. In the financial year to date, the Authority has been operating within the approved limits.

Appendix 2 shows a projected CFR value of £293.29m as at 31st March 2015. The actual CFR as at 31st March 2014 was £272.24m.

4.2.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management are shown in Appendix 1 and the Authority is currently operating within the approved limits.

4.2.3 Prudential Indicators – "Affordability"

There is a requirement to analyse and report the capital financing costs, and express those costs as a percentage of the net revenue streams of the Authority. These are identified in Appendix 2 and currently show a projected reduction from the original budget.

4.2.4 Capital Expenditure and Funding

A summary of capital expenditure and funding is attached at Appendix 3 and shows no change against the planned position. The Capital Strategy Group is currently reviewing this and an update will be provided in the next Treasury Management monitoring report.

5. EQUALITIES IMPLICATIONS

5.1 This report is for information purposes, so the Council's Equalities Impact Assessment (EqIA) process does not need to be applied.

6. FINANCIAL IMPLICATIONS

6.1 As detailed throughout the report.

7. PERSONNEL IMPLICATIONS

7.1 There are no direct personnel implications arising from this report.

8. CONSULTATIONS

8.1 There are no consultation responses that have not been reflected in this report.

9. RECOMMENDATIONS

9.1 Members are asked to note the contents of this report.

10. REASONS FOR THE RECOMMENDATIONS

10.1 Compliance with the CIPFA “Code of Practice for Treasury Management in the Public Services”.

11. STATUTORY POWER

11.1 Local Government Acts 1972 and 2003.

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Appendices:
Appendix 1 Treasury Management Prudential Indicators – Prudence
Appendix 2 Capital Finance Prudential Indicators – Affordability
Appendix 3 Capital Expenditure and Funding