BABERGH DISTRICT COUNCIL AND MID SUFFOLK DISTRICT COUNCIL

To: Joint Audit and Standards Committee	**Report Number: JAC14**
From: Head of Corporate Resources	**Date of meeting: 4 November 2013**

MID YEAR REPORT ON TREASURY MANAGEMENT 2013/14

1. Purpose of Report

1.1 The Code of Practice on Treasury Management requires local authorities to present a mid-year report on treasury management activity to those Members charged with scrutinising this area of activity. This report fulfils that requirement and sets out treasury management activity for the first half of 2013/14.

1.2 The Treasury Management Strategies for 2013/14 were approved at Full Council, on the 26th February 2013 for Babergh (BDC) and 21st February 2013 for Mid Suffolk (MSDC).

1.3 The Joint Treasury Management outturn report for 2012/13 was presented to members at the Joint Audit Committee on 2 September 2013.

2. Recommendation

2.1 Members are requested to review the treasury management activity for the first six months of 2013/14 contained within this report

This is a recommendation to Full Council.

3. Financial implications

3.1 As outlined in this report.

4. Risk Management

4.1 This report is not directly linked with any of the Councils Corporate / Significant Business Risks. Key Treasury Management risks are set out below:

Risk description	Likelihood	Impact	Mitigation measures
Changes to the Bank of England base rate affecting borrowing / lending rates. The bank base rate was predicted to remain low throughout the year, and remains at these levels.	1 Rare or Never	2 Noticeable	Borrowing at fixed rates when rates are low.
Banks / building societies interest rate levels. These change to reflect economic conditions and affect borrowing / lending rates.	3 Often	2 Noticeable	Borrowing at fixed rates when rates are low and researching lowest rates available within borrowing boundaries.
Changes to Debt Management Office (DMO) strategy, which impacts on Public Works Loans Board (PWLB) rates.	2 Occasional	3 Bad	Planning borrowing to take advantage of lower rates.
Liquidity risk: access to cash. With more local authorities investing their surplus cash in money market funds there is a risk of insufficient availability of short term cash. This may result in a cash shortfall for the authority, difficulty in paying bills and having to pay overdraft charges.	2 Occasional	3 Bad	Contingency fund maintained in money market funds.
Counterparty risk: debtors will not pay their bills when they fall due leading to insufficient cash flows.	2 Occasional	3 Bad	Contingency fund maintained in money market funds; strict management of debtors and debtor days outstanding; counterparty list in respect of short term lending is adhered to, which is regularly reviewed, ensuring funds are placed with a view to achieving security, liquidity and yield in that order of priority.

5. Consultations

5.1 Quarterly joint meetings have taken place with our Treasury advisors, Arlingclose, who provide important updates on treasury management issues as they arise.

6. Equality and Diversity Impact

6.1 There are no equality and diversity implications, as the contents and recommendations of this report do not impact on those with protected characteristics.

7. Shared Service / Partnership Implications

7.1 This is a joint report on activity although each council's treasury management strategy and operations are handled separately by CSD and Babergh's in-house finance team currently. These will be aligned once the integrated finance team is established next year,

8. Compliance with Prudential Indicators

8.1 The Councils set their Prudential Indicators in February 2013 as part of the Treasury Management Strategy Statement (BDC: Full Council, 26 February 2013 / MSDC: Full Council 21 February 2013). Appendix D shows the position on key Prudential Indicators for the first six months of 2013/14.

8.2 Both Councils can confirm that they have complied with all Prudential Indicators for 2013/14 to date.

9. Summary

9.1 This report meets the requirements of the CIPFA Code of Practice by providing Members with a summary report of the treasury management activity for the first half of 2013/14.

9.2 As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. Further information is provided in Appendices A to D attached.

10. Appendices

Title	Location
(a) Background, Economy and Outlook for Q3 & 4	Attached
(b) Debt Management	Attached
(c) Investment Activity	Attached
(d) Prudential Indicators	Attached

11. Background Documents

None.

Authorship:

Name: Barry Hunter
Position: Corporate Manager - Finance

Tel: (01473) 825819
E-mail: barry.hunter@babergh.gov.uk

Appendix A: Background, Economy and Outlook for Quarters 3 and 4

1. Background

1.1 The Treasury Management Strategy for 2013/14 is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

1.2 The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures the Councils are embracing best practice in accordance with CIPFA's recommendations.

1.3 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."

1.4 In addition to reporting on risk management related to treasury activities, the Treasury Management Code also requires the Councils to report on any financial instruments entered into to manage treasury risks.

1.5 The instruments and the limits with individual counterparties approved in the 2013/14 Treasury Management Strategy are as follows:

Type of instrument	BDC limit	MSDC limit
Deposits with banks and building societies	£2m	£2m
AAA rated money market funds	£2m	£2m
Deposits with other local authorities	£2m	£5m
Treasury bills	No limit	No limit
Debt Management Account Deposit Facility	No limit	No limit

1.6 In terms of which banks and building societies are included on the Councils' counterparty list, the advice of our treasury management advisors Arlingclose is used. As market conditions and credit ratings change during the year, institutions will either be taken off or put on the list of counterparties that we are happy to lend money to. In practice, the Councils do not have the size of deposit that interests the major banks and building societies, so on a daily basis it is usually the Councils money market funds and call accounts that are used to make short term investments.

2. Economy

2.1 The UK has seen growth in the economy for Quarters 1 and 2 of 2013, with recent data indicating growth also in Quarter 3 with increased consumer spending. Inflation for August 2013 was lower than previous months at 2.7% and is expected to remain close to this level for the rest of 2013. This means that in real terms earnings growth is not falling as rapidly as it was compared to inflation which is good for household spending, but real earnings growth remains relatively low.

2.2 There was no change to UK monetary policy with official interest rates remaining at 0.5%, and with Mark Carney taking over as Governor of the Bank of England it has introduced its forward guidance, meaning interest rates are unlikely to rise until unemployment rates fall to 7%.

3. Outlook for Quarter Three and Four

3.1 At the time of writing this activity report in September 2013, the UK economic outlook appears to have improved but remains relatively subdued. There remains a reliance on consumer spending, but high unemployment and low real earnings growth reflects a general low confidence about the future. The latest forecast for bank rates from our advisors Arlingclose is below:

	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
Official Bank Rate												
Upside risk		0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75
Arlingclose Centra	**0.50**	**0.50**	**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	0.25	0.25

Appendix B: Debt Management

1.1 The table below shows the level of activity on short and long term borrowing between 1st April and 30th September 2013:

BDC Borrowing £'000	Balance 01/04/13	New borrowing	Debt repaid	Balance 30/09/13	Increase/ (Decrease)
Short term	0	0	0	0	0
Long term	88,797	0	(250)	88,547	(250)
Total borrowing	88,797	0	(250)	88,547	(250)

MSDC Borrowing £'000	Balance 01/04/13	New borrowing	Debt repaid/ maturing	Balance 30/09/13	Increase/ (Decrease)
Short term	11,000	14,000	(17,000)	8,000	(3,000)
Long term	81,219	0	(250)	80,969	(250)
Total borrowing	92,219	14,000	(17,250)	88,969	(3,250)

1.2 The tables above show that all new borrowing for Mid Suffolk for the first six months of 2013/14 has been short term in order to take advantage of the relatively low rates. The level of short-term borrowing has reduced though, as it normally does in the first 6 months of the year, due to Council Tax and other income exceeding expenditure.

1.3 ***PWLB Borrowing*:** The Public Works Loan Board (PWLB) remains the most attractive source of borrowing for the Council as it offers flexibility and control. An increase in gilt yields did lead to an increase in PWLB rates over the first 6 months of 2013/14, with 10 year loan rates at 30 September 2013 being 0.83% higher than they were at 1st April:

	PWLB Borrowing Rates: Fixed rate, maturity loans					
	4½-5 yrs	**9½-10 yrs**	**19½-20 yrs**	**29½-30 yrs**	**39½-40 yrs**	**49½-50 yrs**
02/04/2013	1.74	2.83	3.87	4.18	4.25	4.22
29/06/2013	2.34	3.49	4.30	4.52	4.56	4.54
28/09/2013	2.50	3.66	4.36	4.49	4.50	4.48

1.4 ***PWLB Certainty Rates***: The Authorities qualify for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) for a 12 month period from 1st November 2012. In April both Councils submitted its application to the CLG along with the 2013/14 Capital Estimates Return to access this reduced rate for a further 12 month period from 1st November 2013. The Project Rate was announced in the Autumn Statement of 5th December 2012. It will be introduced in November 2013 and will be set at 0.4% below standard PWLB rates, i.e. 0.2% below the Certainty Rate.

1.5 Where possible both Councils make use of internal resources in lieu of external borrowing to fund their capital expenditure as this lowers the overall treasury risk by reducing both external debt and temporary investments. However Mid Suffolk expects it will need to externally borrow £1.5m for capital purposes based on the approved capital programmes for 2013/14 including slippage from 2012/13. Babergh expects to have sufficient internal resources to fund its capital programme until March 2014.

1.6 The reduction in temporary debt has only slightly changed the total debt portfolio of the Councils as follows:

	BDC	**MSDC**
Average Interest Rate 31/03/13 (%)	3.26	3.56
Average Interest Rate 30/09/13 (%)	3.27	3.64
Average life of loans (years)	19	28

1.7 The table below shows an analysis of short term borrowing from April to September 2013 for Mid Suffolk:

MSDC						
Balance at 1 April 2013			£11,000			
Debt maturing in period			£17,000			
New borrowing in period:			£14,000	(See below for details)		
Start date	**Interest rate**	**Loan type**	**Value of Loan £'000**	**Lender**	**Broker**	**Repayment date**
03/06/2013	0.29%	Fixed	3,000	Worcestershire County Council	Martins	03/09/2013
19/06/2013	0.28%	Fixed	2,000	Hartlepool Borough Council	Martins	19/09/2013
24/06/2013	0.29%	Fixed	1,000	Surrey County Council	Sterling	24/09/2013
03/09/2013	0.35%	Fixed	3,000	Cambridge City Council	Martins	03/12/2013
19/09/2013	0.31%	Fixed	2,000	Vale of Glamorgan	Sterling	19/12/2013
19/09/2013	0.31%	Fixed	1,000	Chichester District Council	Sterling	19/12/2013
24/09/2013	0.35%	Fixed	2,000	Derbyshire County Council	Martins	25/11/2013
Balance at 30 September 2013			**8,000**			

1.8 Babergh did not borrow any monies short term between April and September 2013.

Appendix C: Investment Activity

1.1 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Councils aim is to achieve a yield in line with these principles.

1.2 The table below shows the activity on investments between 1 April 2013 and 30 September 2013. During this period both Councils have only made short term investments.

Investments (all short term) £'000	Balance on 01/04/2013	Investments made	Investments Repaid	Balance on 30/09/2013	Increase/ (Decrease) in investments
BDC	3,500	49,405	42,280	10,625	7,125
MSDC	470	46,134	42,590	4,014	3,544

1.3 Further details on the investments made by both councils between April and September 2013 are shown in the tables below:

BDC	**Deposits £'000**	**Redemptions £'000**	**Average interest rate %**	**Interest received £**
Balance 1/04/13	3,500			
April	7,100	4,700	0.60	4,235
May	8,405	5,375	0.60	5,231
June	11,310	10,410	0.58	5,498
July	6,160	5,510	0.57	6,158
Aug	8,310	7,090	0.55	6,070
Sep	8,120	9,195	0.52	5,915
			Total	33,107
Balance 30/09/13	10,625			

MSDC	**Deposits £'000**	**Redemptions £'000**	**Average interest rate %**	**Interest received £**
Balance 1/04/13	470			
April	9,275	7,583	0.44	983
May	6,083	6,933	0.45	1,304
June	10,962	10,904	0.45	225
July	5,113	5,396	0.49	547
Aug	6,504	5,380	0.45	1,536
Sep	7,197	5,394	0.45	846
			Total	5,441
Other investments: (Debt Management Office (DMO))				

May	1,000	1,000	0.25	7
Balance 30/09/13	4,014			

1.4 Security of capital remains the Councils main investment objective. This has been maintained by following the Councils counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14. New investments can be made with the following institutions and instruments for both councils unless specified otherwise:

- Other Local Authorities;
- AAA-rated Stable Net Asset Value Money Market Funds;
- Deposits with UK banks and building societies;
- Deposits with the Debt Management Account Deposit Facility; and
- Treasury Bills.

1.5 Counterparty credit quality is assessed and monitored with reference to:

- Credit ratings, the Councils minimum long-term counterparty rating of A- (or equivalent) across rating agencies Fitch, Standard and Poor's and Moody's;
- credit default swaps;
- GDP of the country in which the institution operates;
- the country's net debt as a percentage of GDP;
- sovereign support mechanisms /potential support from a well-resourced parent institution;
- share price.

1.6 Credit (Security) Risk: The aim is to have an average credit rating of A- or higher, with a score of seven or lower, to reflect the current investment approach with the main focus being on security of the investment.

BDC	**Value Weighted Average – Credit Risk Score**	**Value Weighted Average – Credit Rating**	**Time Weighted Average – Credit Risk Score**	**Time Weighted Average – Credit Rating**
31/03/2013	6.30	A	5.50	A
30/06/2013	5.27	A+	5.80	A
30/09/2013	5.24	A+	5.97	A

MSDC	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2013	5.68	A	5.68	A
30/06/2013	5.67	A	5.67	A
30/09/2013	5.19	A+	4.68	A+

Scoring
Value weighted average reflects the credit quality of investments according to the size of the deposit. Time weighted average reflects the credit quality of investments according to the maturity of the deposit.
AAA = highest credit quality = 1
D = lowest credit quality = 26

1.7 ***Counterparty Update:*** In April Fitch downgraded the UK's long-term sovereign rating by one notch from AAA to AA+. In May Moody's downgraded the long-term rating of Co-op Bank by six notches from A3 to Ba3 and down again to Caa1 which is sub-investment grade. The Co-op is Babergh's banker and therefore the council has exposure to the institution. Officers have taken appropriate action in relation to this including minimising overnight balances. Short-term alternative contingency arrangements i.e. a back up/reserve current account with another bank are being explored.

A procurement exercise is underway to appoint bankers for both Babergh and Mid Suffolk in conjunction with 3 other Suffolk Councils.

In the Chancellor's Mansion House speech on 19 June 2013 he signalled his intention to sell the government's stake in the Lloyds Banking Group reasonably soon and a 6% stake was indeed sold to institutional investors on 17 September 2013 at a price of 75p. In a positive move, Fitch upgraded Lloyds' viability rating to bbb+.

In June 2012 Moody's (credit rating agency) completed its review of banks with global capital market operations, downgrading the long-term ratings of all of them. The banks on the Councils' lending lists which were affected by the ratings downgrades were Barclays, HSBC and Royal Bank of Scotland. Separately, the agency also downgraded the ratings of Lloyds TSB, Bank of Scotland, National Westminster Bank and Santander UK plc. None of the long-term ratings of the banks on the Councils' lending lists were downgraded to below the Councils' minimum A- credit rating threshold.

1.8 The institutions on the both Councils investment counterparty list, based on latest Arlingclose advice, are:

Institution	Maximum period for investment	Council
Royal Bank of Scotland and National Westminster	Overnight	BDC & MSDC
Close Brothers	100 days	BDC & MSDC
Lloyds TSB and Bank of Scotland	6 months	BDC & MSDC
HSBC Bank, Barclays Bank, Nationwide Building Society and Standard Chartered Bank.	12 months	BDC & MSDC
Australia & New Zealand Banking Group, Commonwealth Bank of Australia, National Australia Bank, Westpac Banking Group, Royal bank of Canada, Toronto-Dominion Bank, Nordea Bank, Bank Nederlandse Gemeenten NV (BNG), Rabobank and Svenska Handeksbanken	12 months	BDC

1.9 ***Budgeted Income and Outturn***: The UK Bank Rate has been maintained at 0.5% since March 2009 and is not expected to rise until 2016/17. Short-term money market rates have remained at very low levels for investments, (see table below). The anticipated interest receivable for 2013/14 is as follows:

£'000	**BDC**	**MSDC**
Average money market rate	0.37%	0.38%
Budget for 2013/14	55	3
Predicted Outturn for 2013/14	57	7

Appendix D: Prudential Indicators

1.1 Capital Financing Requirement

Estimates of the Councils cumulative maximum external borrowing requirement for 2012/13 to 2014/15 are shown in the table below:

BDC	31/03/2013 Actual £000	31/03/2014 Estimate £000	31/03/2015 Estimate £000	31/03/2016 Estimate £000
Capital Financing Requirement	94,424	94,732	95,711	95,594
Less: Existing Profile of Borrowing	88,797	88,297	87,797	87,297
Cumulative Maximum External Borrowing Requirement	5,627	6,435	7,914	8,297

MSDC	31/03/2013 Actual £000	31/03/2014 Estimate £000	31/03/2015 Estimate £000	31/03/2016 Estimate £000
Capital Financing Requirement	101,800	105,200	108,214	109,090
Less: Existing Profile of Borrowing	92,219	91,397	86,867	86,371
Cumulative Maximum External Borrowing Requirement	9,581	13,803	21,347	22,719

Both Councils are well within the capital financing requirement.

1.2 Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent, but not worst case scenario without the additional headroom included within the Authorised Limit. The Authorised Limit and Operational Boundary for 2013/14 are as follows:

£'000	**Authorised Limit**	**Operational Boundary**	**Peak Borrowing up to 30/09/13**
BDC	98,000	96,000	88,797
MSDC	110,000	108,000	92,219

The Section 151 Officers confirm that there were no breaches to the Authorised Limit and the Operational Boundary in the year to end of September.

1.3 Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments. The limits for 2013/14 mean that Mid Suffolk can have all of its loans / investments at a fixed rate, but only 50% at a variable rate. Babergh can have all of its loans / investments at a fixed rate but only 30% of loans and 75% of investments at a variable rate.

Limits for 2013/14 %	**BDC**	**MSDC**
Upper limit for fixed rate exposure	100	100
Compliance with limits:	Yes	Yes
Upper limit for variable rate exposure on debt	30	50
Upper limit for variable rate exposure on	75	50
Compliance with limits:	Yes	Yes

1.4 Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

BDC **Maturity Structure of Fixed Rate Borrowing**	**Upper Limit %**	**Lower Limit %**	**Actual Fixed Rate Borrowing as at 30/09/13 £000s**	**% Fixed Rate Borrowing as at 30/09/13 £000s**	**Compliance with set limits?**
Under 12 months	50	0	500	0.56	Yes
12 to < 24 months	50	0	500	0.56	Yes
24 months to < 5 years	50	0	1,500	1.7	Yes
5 years to <10 years	10	0	1,300	1.4	Yes
10 years and above	100	0	84,747	95.71	Yes

MSDC **Maturity Structure of Fixed Rate Borrowing**	**Upper Limit %**	**Lower Limit %**	**Actual Fixed Rate Borrowing as at 30/09/13 £000s**	**% Fixed Rate Borrowing as at 30/09/13 £000s**	**Compliance with set limits?**
Under 12 months	30	0	12,000	13.5	Yes
12 to < 24 months	40	0	4,213	4.7	Yes
24 months to < 5 years	60	0	1,319	1.5	Yes
5 years to <10 years	60	0	2,400	2.7	Yes
10 years and above	100	0	69,037	77.6	Yes

1.5 Total Principal Sums Invested for Periods Longer than 364 Days

This indicator allows the Council to manage the risk inherent in investments longer than 364 days.

Investments over 364 days £'000	**BDC**	**MSDC**
Limit	2,000	0
Amount invested	0	0

Neither council had investments longer than 364 days in the six month period to 30 September 2013.

1.6 HRA Limit on Indebtedness

This purpose of this indicator is for the Council to report on the level of the limit imposed at the time of implementation of self-financing by the Department for Communities and Local Government. The table below shows that the Councils are within this indicator.

BDC **HRA Limit on Indebtedness**	**31/03/2013 Actual £000s**	**31/03/2014 Estimate £000s**	**31/03/2015 Estimate £000s**	**31/03/2016 Estimate £000s**
HRA CFR	89,348	88,848	88,348	87,848
HRA Debt Cap (as prescribed by CLG)	97,849	97,849	97,849	97,849
Difference	8,501	9,001	9,501	10,001

MSDC **HRA Limit on Indebtedness**	**31/03/2013 Actual £000s**	**31/03/2014 Estimate £000s**	**31/03/2015 Estimate £000s**	**31/03/2016 Estimate £000s**
HRA CFR	86,759	87,860	89,267	89,735
HRA Debt Cap (as prescribed by CLG)	90,851	90,851	90,851	90,851
Difference	4,092	2,991	1,584	1,116