Bath & North East Somerset Council		
MEETING:	**Corporate Audit Committee**	
MEETING DATE:	**3rd December 2013**	
TITLE:	**Treasury Management Monitoring Report to 30th September 2013**	
WARD:	All	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Council's Investment Position at 30th September 2013
Appendix 3 – Average monthly rate of return for 1st 6 months of 2013/14
Appendix 4 – The Council's External Borrowing Position at 30th September 2013
Appendix 5 – Arlingclose's Economic & Market Review Q2 of 2013/14
Appendix 6 – Interest & Capital Financing Budget Monitoring 2013/14
Appendix 7 – Summary Guide to Credit Ratings

1 THE ISSUE

1.1 In February 2012 the Council adopted the 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan 2013/14 for the first six months of 2013/14.

2 RECOMMENDATION

The Corporate Audit Committee agrees that:

2.1 the Treasury Management Report to 30th September 2013, prepared in accordance with the CIPFA Treasury Code of Practice, is noted

2.2 the Treasury Management Indicators to 30th September 2013 are noted.

3 RESOURCE IMPLICATIONS (FINANCE, PROPERTY, PEOPLE)

3.1 The financial implications are contained within the body of the report.

4 STATUTORY CONSIDERATIONS AND BASIS FOR PROPOSAL

4.1 This report is for information only.

5 THE REPORT

Summary

5.1 The average rate of investment return for the first six months of 2013/14 is 0.49%, which is 0.08% above the benchmark rate.

5.2 The Council's Prudential Indicators for 2013/14 were agreed by Council in February 2013 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

5.3 The Council's investment position as at 30th September 2013 is given in **Appendix 2**. The balance of deposits as at 30th June 2013 & 30th September 2013 are also set out in the pie charts in this appendix.

5.4 The Council is the accountable body for the West of England Revolving Investment Fund (RIF) and received grant funding of £57 million at the end of the 2011/12 financial year. The Council acts as an agent and holds these funds on behalf of the West of England Local Enterprise Partnership until they are allocated in the form of repayable grants to the constituent Local Authorities to meet approved infrastructure costs. Since these funds are invested separately from the Council's cash balances and have been placed short term with the Debt Management Office and other Local Authorities, they are excluded from all figures given in this report.

5.5 Gross interest earned on investments for the first six months totalled £228k. Net interest, after deduction of amounts due to West of England Growth Points, B&NES PCT Pooled Budgets and schools, is £183k. **Appendix 3** details the investment performance, the average rate of interest earned over this period was 0.49%, which is 0.08% above the benchmark rate of average 7 day LIBID +0.05% (0.41%).

Summary of Borrowings

5.6 The Council has now implemented the restructuring of its Public Works Loan Board debt portfolio by utilising Council's cash flow, which, as can be seen above, is currently earning very low rates of interest. The rescheduling of £50 million of borrowing was completed during the second quarter of 2013/14.

5.7 Current forecasts project that the savings in the current year will meet the additional £500K savings target in the Council's 2013/14 approved budget, as well as generating an additional £600k saving. This is achieved by netting off the loss of interest earned on the cash balance against the reduced interest payments made to the Public Works Loan Board.

5.8 The Council's reduced total borrowing was £70 million as at the 30th September 2013. The Council's Capital Financing Requirement (CFR) as at 31st March 2013 was £141.8 million with a projected total of £201 million by the end of 2013/14 based on the capital programme approved at February 2013 Council. This represents the Council's need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

5.9 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2013 apportioned to Bath & North East Somerset Council is £15.14m. Since this borrowing is managed by Bristol City Council and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 5.8.

5.10 The borrowing portfolio as at 30th September 2013 is shown in **Appendix 4**.

Strategic & Tactical Decisions

5.11 As shown in the charts at Appendix 2, investments continue to be focussed on UK banks that have either already or are likely to receive support from the UK Government should they experience financial difficulties. As at 30th September 2013, £3.0m was invested with other Local Authorities to increase diversification whilst maintaining strong counterparty rating. To increase diversification further, the Council invests in AAA rated Money Market funds, with a balance of £6.5m invested in these as at 30th September 2013.

5.12 The overall decrease in the Council's cash balance between 30th June 2013 and 30th September 2013, as detailed in **Appendix 2**, is a reflection of the debt repayments that have been made during that period, as detailed in paragraph 5.6 above.

5.13 The Council continues to not invest with banks in countries within the Eurozone. The Council's investment counterparty list does not include any banks from the countries most affected by the Eurozone debt situation (Portugal, Ireland, Greece, Spain and Italy).

5.14 The Council's average investment return is running below the budgeted level of 0.75% due to the continued reduction in current market rates. Also, in line with the debt restructuring strategy, the majority of the remaining cash balance is required for short term cashflow, so cannot be locked into the slightly higher longer term rates. The reduced return is more than offset by the reduced interest payments, as set out in **Appendix 6**.

Future Strategic & Tactical Issues

5.15 Our treasury management advisors economic and market review for the second quarter 2013/14 is included in **Appendix 5**.

5.16 The Bank of England base rate has remained constant at 0.50% since March 2009.

Budget Implications

5.17 A breakdown of the revenue budget for interest and capital financing and the forecast year end position based on the period April to September is included in **Appendix 6**. This is currently forecast to be £600k underspend for 2013/14, resulting from the recent debt rescheduling.

6 RATIONALE

6.1 The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

7 OTHER OPTIONS CONSIDERED

7.1 None.

8 CONSULTATION

8.1 Consultation has been carried out with the Cabinet Member for Community Resources, Section 151 Finance Officer, Chief Executive and Monitoring Officer.

8.2 Consultation was carried out via e-mail.

8.3 This report was also presented to November Cabinet and November Council.

9 RISK MANAGEMENT

9.1 A risk assessment related to the issue and recommendations has been undertaken, in compliance with the Council's decision making risk management guidance.

9.2 The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment & Borrowing advice is provided by our Treasury Management consultants Arlingclose.

9.3 The 2011 edition of the CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. In February 2012, the Council's treasury advisors provided training to the Corporate Audit Committee to carry out this scrutiny.

9.4 In addition, the Council maintain a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year.

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Background papers	*2013/14 Treasury Management & Investment Strategy*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2013/14 Prudential Indicator	**2013/14 Actual as at 30th Sep. 2013**
	£'000	£'000
Borrowing	201,000	70,000
Other long term liabilities	2,000	0
Cumulative Total	**203,000**	**70,000**

2. Operational limit for external debt
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2013/14 Prudential Indicator	**2013/14 Actual as at 30th Sep. 2013**
	£'000	£'000
Borrowing	167,000	70,000
Other long term liabilities	2,000	0
Cumulative Total	**169,000**	**70,000**

3. Upper limit for fixed interest rate exposure
This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2013/14 Prudential Indicator	**2013/14 Actual as at 30th Sep. 2013**
	£'000	£'000
Fixed interest rate exposure	**201,000**	**50,000***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the rate increase)

4. Upper limit for variable interest rate exposure
While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2013/14 Prudential Indicator	**2013/14 Actual as at 30th Sep. 2013**
	£'000	£'000
Variable interest rate exposure	**60,000**	**20,000**

5. Upper limit for total principal sums invested for over 364 days

This is the maximum amount of total investments which can be over 364 days. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

	2013/14 Prudential Indicator	**2013/14 Actual as at 30th Sep. 2013**
	£'000	£'000
Investments over 364 days	**50,000**	**0**

6. Maturity Structure of new fixed rate borrowing during 2013/14

This indicator is set to control the Council's exposure to refinancing risk.

	Upper Limit	**Lower Limit**	**2013/14 Actual as at 30th Sep. 2013**
	%	%	%
Under 12 months	50	Nil	0
12 months and within 24 months	50	Nil	0
24 months and within 5 years	50	Nil	0
5 years and within 10 years	50	Nil	0
10 years and above	100	Nil	100

7. Average Credit Rating

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio.

	2013/14 Prudential Indicator	**2013/14 Actual as at 30th Sep. 2013**
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A**	**AA-**

APPENDIX 2

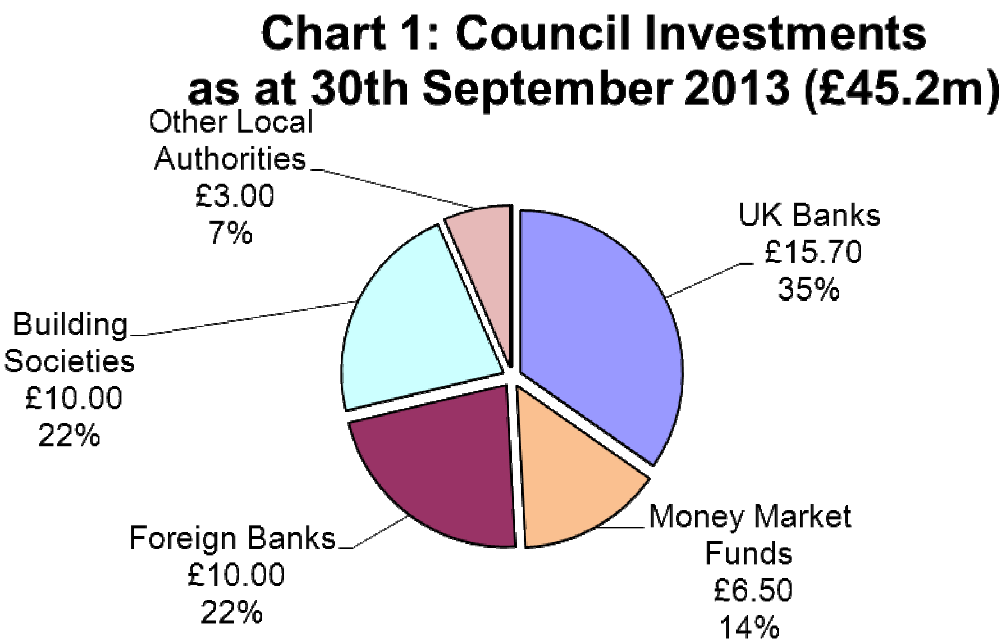
The Council's Investment position at 30th September 2013

	Balance at 30th September 2013
	£'000's
Notice (instant access funds)	12,200
Up to 1 month	20,000
1 month to 3 months	13,000
Over 3 months	0
Total	**45,200**

The investment figure of £45.2 million is made up as follows:

	Balance at 30th September 2013
	£'000's
B&NES Council	24,510
B&NES PCT	11,472
West Of England Growth Points	685
Schools	8,533
Total	**45,200**

The Council had an average net positive balance of £93.7m (including Growth Points & B&NES PCT Funding) during the period April 2013 to September 2013.



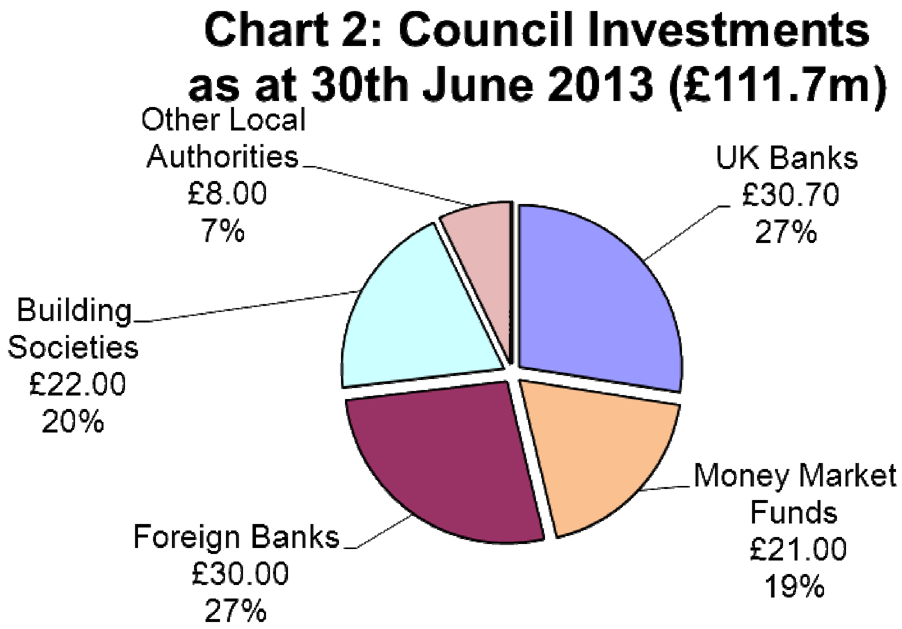


Chart 2: Council Investments
as at 30th June 2013 (£111.7m)
Other Local
Authorities
£8.00
7%
UK Banks
£30.70
27%
Building
Societies
£22.00
20%
Money Market
Funds
£21.00
19%
Foreign Banks
£30.00
27%

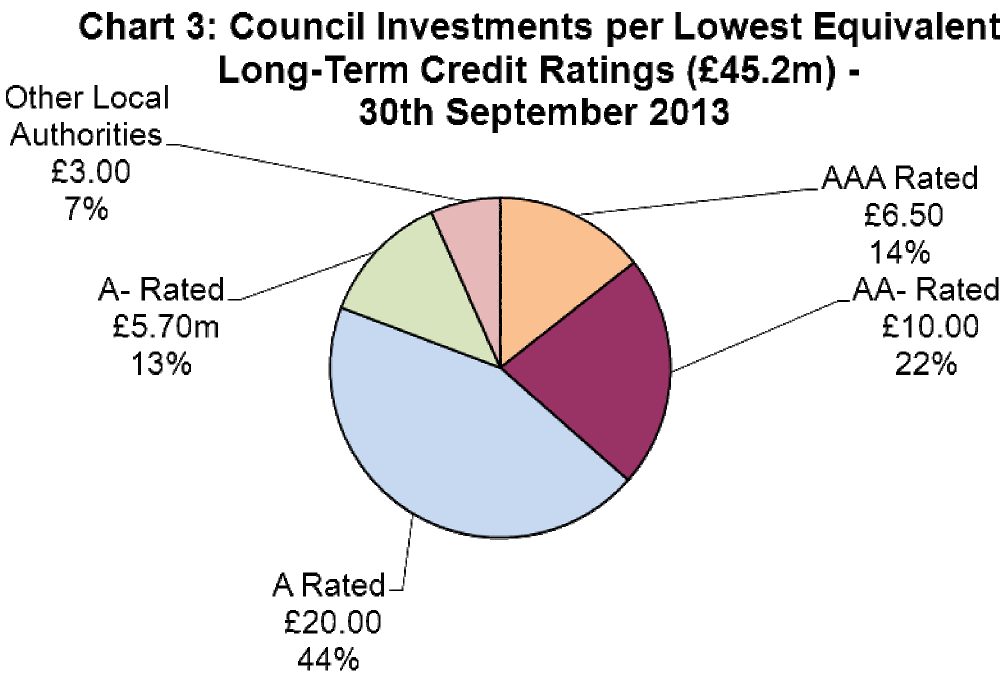
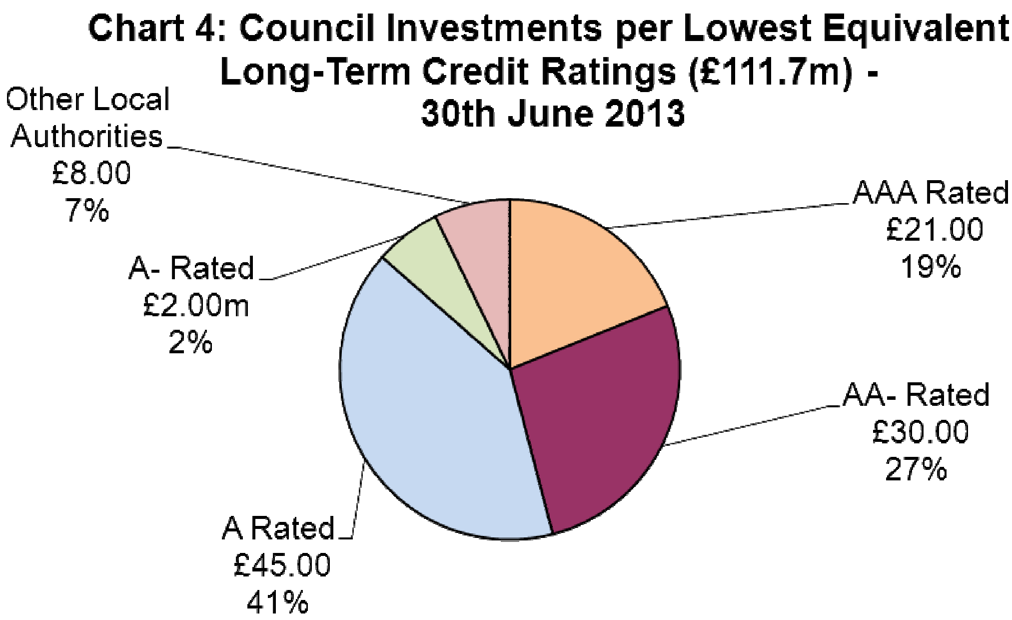


Chart 3: Council Investments per Lowest Equivalent
Long-Term Credit Ratings (£45.2m) -
30th September 2013
Other Local
Authorities
£3.00
7%
AAA Rated
£6.50
14%
A- Rated
£5.70m
13%
AA- Rated
£10.00
22%
A Rated
£20.00
44%



APPENDIX 3

Average rate of return on investments for 2013/14

	Apr. %	**May %**	**Jun. %**	**Jul. %**	**Aug. %**	**Sep. %**	**Average for Period**
Average rate of interest earned	0.49	0.48	0.47	0.50	0.49	0.49	**0.49%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.42	0.41	0.41	0.41	0.41	0.40	**0.41%**
Performance against Benchmark %	+0.07	+0.07	+0.06	+0.09	+0.08	+0.09	**+0.08%**

APPENDIX 4
Councils External Borrowing at 30th September 2013

LONG TERM	Amount	Fixed Term	Interest Rate	Variable Term	Interest Rate
PWLB	10,000,000	30 yrs	4.75%	n/a	n/a
PWLB	5,000,000	25 yrs	4.55%	n/a	n/a
PWLB	5,000,000	50 yrs	4.53%	n/a	n/a
PWLB	5,000,000	20 yrs	4.86%	n/a	n/a
PWLB	10,000,000	18 yrs	4.80%	n/a	n/a
PWLB	15,000,000	50 yrs	4.96%	n/a	n/a
KBC Bank N.V*	5,000,000	2 yrs	3.15%	48 yrs	4.50%
KBC Bank N.V*	5,000,000	3 yrs	3.72%	47 yrs	4.50%
Eurohypo Bank*	10,000,000	3 yrs	3.49%	47 yrs	4.50%
TOTAL	**70,000,000**				

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower also has the option to repay the loan without penalty.

APPENDIX 5
Economic and market review for July 2013 to September 2013 (Arlingclose)

Growth: The UK economy showed some improvement, with consumer spending boosting growth. GDP for the first quarter of 2013 was revised up to +0.4% and for the second quarter was +0.7%. Recent data suggests a stronger rate in quarter three. Revisions by the Office of National Statistics to GDP back-data showed the UK avoided a double-dip recession in 2012, but that the downturn in 2008-09 was deeper than previously estimated. Growth is now still over 3% below its peak back in 2007.

Some positive signs for household spending emerged. The deterioration in real earnings growth (i.e. earnings less inflation) slowed, which implied a slower erosion of purchasing power. Consumer confidence improved. Household savings rates remained high, which is unsurprising given the uncertain economic outlook, but appear to be on a downward track, suggesting spending was being driven by borrowing or lower savings. This raises questions about the sustainability of the recovery at these rates of growth.

Inflation: Annual CPI for August (published September) was 2.7%. Inflation fell in line with expectations and is expected to remain close to this level throughout the autumn. Further out, inflation should fall back towards the 2% target as external price pressures fade and a revival in productivity growth curbs domestic cost pressures. The oil price (Brent Crude) climbed above $100/barrel on the back of political unrest in Egypt and the unresolved crisis in Syria.

Monetary Policy: There was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.5% and £375bn respectively. The main development for UK monetary policy was the start of Mark Carney's tenure as Governor and the implementation of forward guidance. Within the August Inflation Report, the Bank stated its forward guidance, the main element of which is to defer monetary tightening at least until the ILO Unemployment Rate falls to a threshold of 7% (among a raft of caveats). The Bank projected that the probability of this happening would remain below 50% until 2016. The Governor has had to defend the Bank's guidance in the face of rising financial market expectations of an earlier rate rise on the back of the encouraging economic data.

In his testimony to Congress on 22nd May the US Federal Reserve Chairman Ben Bernanke stated that, if the nascent recovery in the US economy became established, the Fed would reduce its $85bn monthly asset purchase programme (QE). The apparent movement by the Fed towards tapering its open-ended QE programme prompted extreme asset price volatility in bonds and equities, as investors sought to crystallise gains driven by excessive liquidity. As a consequence, government bond yields spiked. There had been a growing expectation that the Federal Reserve would seek to commence 'tapering' in September but they took markets by surprise and maintained asset purchases at the existing level.

Global: Whilst the outlook for the global economy appeared to have improved over the first half of calendar 2013/14, significant economic risks remain, particularly in China and the Eurozone. The Chinese banking system is facing tighter liquidity conditions as officials seek to slow down rampant credit growth, and, despite the time gained by the ECB to allow individual members and the Eurozone as a whole to reform their economies, the Eurozone debt crisis has not gone away. The region appears to be dragging itself out of recession and September's German general election passed with little incident but political uncertainties, particularly in Italy, could derail any progress towards a more balanced and stable regional economy. The US recovery appeared to be in train, but a lack of agreement on the federal budget by the end of September caused a partial government shutdown at the start of October, which could have an effect on GDP growth. Political risks also remain regarding the debt ceiling.

Outlook: At the time of writing this activity report in September 2013, the UK economic outlook appears to have improved. The projected path for growth has risen, but remains relatively subdued, with a distinct reliance on household consumption, which itself remains under pressure given the deterioration in real earnings growth, high unemployment and general low confidence. A variety of other factors will continue to weigh on a domestic recovery, including on-going fiscal consolidation, muted business confidence and subdued foreign demand. While the economic recovery may pick up steam, forward guidance from the Bank of England suggests that monetary policy is unlikely to be tightened until the ILO Unemployment Rate falls below 7%. The Bank projected this level would be reached in 2016.

APPENDIX 6
Interest & Capital Financing Costs – Budget Monitoring 2013/14 (April to September)

April to September 2013	YEAR END FORECAST Budgeted Spend or (Income) £'000	Forecast Spend or (Income) £'000	Forecast over or (under) spend £'000	ADV/FAV
Interest & Capital Financing				
- Debt Costs	4,947	4,097	(850)	FAV
- Internal Repayment of Loan Charges	(6,584)	(6,584)		
- Ex Avon Debt Costs	1,388	1,388		
- Minimum Revenue Provision (MRP)	4,782	4,782		
- Interest on Balances	(455)	(205)	250	ADV
Sub Total - Capital Financing	**4,078**	**3,478**	**(600)**	**FAV**

APPENDIX 7
Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.