East Lothian Council

REPORT TO: Audit and Governance Committee

MEETING DATE: 19 November 2013

BY: Depute Chief Executive - Resources & People Services

SUBJECT: Treasury Management Strategy Statement & Annual Investment Strategy – Mid-year Review 2013/14

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1 PURPOSE

1.1 To update the Committee on Treasury Management activity during the first half of 2013/14.

2 RECOMMENDATIONS

2.1 The Committee are asked to note the content of the report

2.2 The Committee are also asked to note that a report on 2012/13 Treasury Management has been lodged in the Members' Library.

3 BACKGROUND

3.1 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 a way which takes account of risk and return.

3.2 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.

3.3 Specialist Treasury Management advice is provided to the Council on a contractual basis by Sector. This service includes daily market updates and regular review meetings. Operational decisions are made by the

Corporate Finance Manager in accordance with the approved Treasury Management Strategy, in consultation with the Head of Council Resources and after considering the advice provided by Sector.

3.4 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the 2013/14 financial year to 30 September 2013;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy approved by the Council on 26th February 2013;
- A review of the Council's borrowing strategy for 2013/14
- A review of the Council's investment activity for 2013/14;

Extract from Sector's Economic update

3.5 During 2013/14 economic indicators suggested that the UK 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.

3.6 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. With respect to pay growth, excluding bonuses, earnings rose by just 1.0% y/y, well below the rate of inflation at 2.7% in August, causing continuing pressure on household's disposable income.

3.7 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.

3.8 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. 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.

3.9 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.

Economic Outlook for the next six months of 2013/14

3.10 Economic forecasting remains difficult with so many external influences weighing on the UK. Volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, and safer bonds. Downside risks to UK gilt yields and PWLB rates include a return to weak economic growth in the US, UK and China causing major disappointment to investor and market expectations, continuing concerns in the Eurozone and geopolitical risks such as the current situation in Syria.

3.11 There are also a number of upside risks for UK gilt yields and PWLB rates, especially longer term PWLB rates. These risks include UK inflation being significantly higher than in the wider EU and US, increased investor confidence causing a further flow of funds out of bonds into equities, a reversal of Quantitative Easing (QE) in the UK and further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt.

3.12 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.

Interest rate forecasts

3.13 The following table shows Sector's forecast for interest 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%

Review of the Treasury Management Strategy Statement and Annual Investment Strategy

3.14 There are no policy changes to the Treasury Management Strategy Statement (TMSS) approved by the Council on 26th February 2013. No changes are required to the prudential indicators approved in the TMSS and approved prudential indicators have been complied with during the first six months of 2013/14.

Borrowing Update

3.15 During the first 6 months of 2013/14 borrowing decisions were taken in accordance with the approved strategy. The Council continued to take advantage of short term borrowing from other public sector bodies at rates below bank base rate which provided a pragmatic solution to managing cash flow. At the same time the need to safeguard against rising PWLB rates resulted in some longer term borrowing. No debt restructuring was undertaken during the period covered by this report.

3.16 During the first 6 months of 2013, the following new PWLB loans were taken out:

Date of Borrowing	Principal	Maturity	Interest Rate
24/4/2013	£1m	49 years	3.96%
24/4/2013	£2m	19	3.6%

3.17 One PWLB loan matured during the period and was repaid:

Date repaid	Principal	Maturity	Interest rate
24/9/13	£10m	5 years	3.09%

3.18 The following short term loans were taken from other public sector bodies:

Date of borrowing	Lender	Amount	Interest rate	Repayment Date
5/8/13	Derbyshire CC	£5m	0.4%	5/2/14
5/8/13	Worcestershire CC	£5m	0.3%	5/11/13
5/8/13	Merseyside ITA	£5m	0.4%	5/2/14
24/9/13	City of Edinburgh	£10m	0.5%	24/12/13
30/9/13	Kensington & Chelsea	£5m	0.38%	28/2/14

3.19 The following short term loans matured and were repaid:

Date of borrowing	Lender	Amount	Interest rate	Date repaid
22/1/13	Swansea CC	£3m	0.32%	22/4/13
28/1/13	Northumberland CC	£2m	0.32%	29/4/13
14/12/12	Surrey Heath BC	£1.5m	0.4%	14/6/13
30/10/12	Ealing	£2m	0.4%	30/7/13

Investment Update

3.20 Investment decisions during the first 6 months of 2013/14 were taken in accordance with the approved strategy. There were no new investments during the period and surplus cash balances were held in the Council's bank account.

3.21 East Lothian Council Common Good funds and Charitable Trust funds are managed in two separate portfolios by an external investment management company, Investec. At 30th September 2013, the East Lothian Charitable Trust portfolio was valued at £2.68m while the Common Good portfolio was valued at £2.735m.

4 POLICY IMPLICATIONS

4.1 There are no direct policy implications associated with this report however the Council's treasury management activity is determined by the policy framework set out in the approved Treasury Management Strategy.

5 EQUALITIES IMPACT ASSESSMENT

5.1 This report is not applicable to the well being of equalities groups and an Equalities Impact Assessment is not required.

6 RESOURCE IMPLICATIONS

6.1 Financial – There are no direct financial implications associated with this report however the Council's Treasury Management activity clearly has a significant impact on the management of the Council's financial resources.

6.2 Personnel - None

6.3 Other - None

7 BACKGROUND PAPERS

7.1 Treasury Management Strategy 2013/14 to 2015/16 – East Lothian Council 26 February 2013

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