CARDIFF COUNCIL
CYNGOR CAERDYDD

COUNCIL: 19 DECEMBER 2013

CABINET PROPOSAL AGENDA ITEM: 9

TREASURY MANAGEMENT MID-YEAR REPORT 2013-14

Annexes A&B to Appendix 1 to this report are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Reason for this Report

1. To inform Members of the Council's treasury management activities since 1 April 2013 and the position as at 31 October 2013.

Background

2. The Council's treasury management activities are governed by legislation and a Code of Practice developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) updated in 2011.

Issues

3. In the budget report of February 2010, Council adopted CIPFA's revised Treasury Management Code by formal acceptance of the Four Clauses of Treasury Management and Treasury Management Policy Statement as Council policy. In accordance with these policies, this report provides members with a mid year update of Treasury Management activities as at 31st October 2013. Council requires the scrutiny of the accounting, audit and commercial issues of its Treasury Management Strategy and Practices to be undertaken by the Council's Audit Committee. The mid-year monitoring report is attached as Appendix 1 and is to be referred to Council on the 19 December 2013 after consideration by the Cabinet and Audit Committee on the 2 December 2013.

Reasons for Recommendations

4. Council policy requires the Treasury Management Mid Year Report 2013-14 update to be submitted to Council.

Legal Implications

5. No direct legal implications arise from this report.

Financial Implications

6. The Council's treasury management activities are undertaken in accordance with the policies adopted by Council and under professional codes of conduct established by CIPFA, the Welsh Government and the Interim Section 151 Officer as part of treasury management practices. This report is part of a suite of reports that members receive on the Council's treasury management activities during the course of a year. Whilst there are no direct financial implications arising from this report, the risks involved with treasury management are continuously reviewed in conjunction with the Council's treasury management advisors.

CABINET PROPOSAL

Council is recommended to note the Treasury Management Mid Year Report 2013-14 (Appendix 1)

THE CABINET
9 December 2013

The following Appendix is attached:-

Appendix 1: Treasury Management Mid Year Report 2013-14

Appendix 1

Annexes A&B to this Appendix are not for publication as they contain exempt information of the description in Paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Treasury Management Mid-Year Report 2013-14

The County Council of the City and County of Cardiff

Report of Interim Section 151 Officer

Introduction

1.1. Treasury management activities are the management of an organisation'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.

1.2. The Council carries out its treasury management activities in accordance with a code developed for public services in 2011 by the Chartered Institute of Public Finance and Accountancy (CIPFA) as well as Council approved policies and clauses adopted by Council in February 2010.

1.3. In accordance with these policies, this report provides members with a mid year update of Treasury Management activities as at 31 October 2013 and covers:-

- the economic background to treasury activities
- investments
- borrowing
- debt rescheduling
- compliance with treasury limits and prudential indicators
- other treasury management issues

Economic Background and Treasury Strategy Update

2.1 Economic forecasting remains difficult with so many external influences weighing on the UK. Recent indicators such as employment, retail sales, mortgage approvals and house prices have suggested the economy is recovering.

2.2 The following table gives the Council's treasury management advisors, latest forecast of bank rate and Public Works Loan Board (PWLB) borrowing rates:

	Nov-13	Mar-14	Mar-15	Mar-16	Mar-17
Bank Rate	0.50%	0.50%	0.50%	0.50%	1.25%
5yr PWLB rate	2.30%	2.50%	2.80%	3.20%	3.70%
10yr PWLB rate	3.46%	3.70%	3.90%	4.30%	4.60%
25yr PWLB rate	4.24%	4.40%	4.60%	5.00%	5.20%
50yr PWLB rate	4.26%	4.40%	4.70%	5.10%	5.30%

2.3 Compared to the strategy approved in February 2013, the latest interest rate forecast of the treasury advisor indicates that Bank Rate will stay at low levels for a longer period of time, with base rate remaining at 0.5% until September 2016 at least, reflecting economic growth concerns and the Bank of England's forward guidance. It can be seen from the table that the cost of borrowing is significantly in excess of the rates that are available from investments.

2.4 PWLB rates have risen in 2013/14 following the previous lows seen in 2012/13 when concerns about the level of growth in the world economy and also the perceived safe haven of UK Government Gilts in comparison to other western economies made borrowing rates favourable. The long term trend is for PWLB rates to rise due to the high volume of debt issuance in the UK. Increased confidence in growth, higher inflation expectations, credit downgrades and continued reversal of safe haven status could result in continued increases in borrowing rates. Conversely re-emergence of problems in heavily indebted and politically frail European economies as well as geopolitical risks such as in the Middle East could result in safe haven flows back to the UK, reducing borrowing rates.

2.5 Whilst there is less volatility in the financial and banking market, both globally and in the UK, risks still remain and this is demonstrated by the recently proposed financial restructuring at Co-Operative Bank, who provides banking services to the Council. The Co-Op has notified the Council of its phased withdrawal of services to local authorities and that it will not be looking to submit a tender when the Council re-tenders its banking services contract to commence from 1 April 2014. Such changes are continually reviewed against the strategy approved in February 2013 and further detail is provided in the section below.

Investment

3.1 The management of the Council's cash flows may involve temporary lending of surplus funds to low risk counterparties or temporary borrowing pending receipt of income.

3.2 The Council's investment priorities are the security and then liquidity of its investments. The Council also aims to achieve the optimum return on its investments appropriate to these priorities.

3.3 The Council invests with financial institutions listed on the Council's approved lending list. The categories, names, periods and size limits on this list can be extended, varied or restricted at any time by the Interim Section 151 Officer under delegated powers. Based primarily on Fitch credit criteria and a number of other factors which the Council takes into account, lending to these institutions is subject to time and size limits and credit worthiness continues to be carefully monitored.

3.4 Given that bank rates are historically low, and the damping effect on interest rates that the Governments Funding for Lending Scheme has had on availability of cash to banks, rates of investment return have greatly reduced compared to previous years. Whilst higher returns are available for investments for longer periods, economic and the current financial uncertainties the Council itself operates in prompts a low risk and short term strategy for treasury investments.

3.5 At the 31 October 2013, investments stood at £52.3 million. These temporary funds fluctuate daily and arise for a number of reasons, including the timing differences between the receipt of grant and other income and the utilisation of these funds on salaries and other operating costs. It includes the level of reserves, provisions, and other balances. It is also affected by the timing of borrowing and capital expenditure transactions. **Annexe A** shows with whom these investments were held as at 31 October 2013. These were all deemed recoverable.

3.6 A selection of performance indicators and benchmarking charts as provided to Audit Committee, is included in **Annexe B** as follows:-

- **Counterparty Exposure** displays actual investment against the maximum permitted directly with an organisation – This demonstrates that we are not exceeding any exposure limits.
- **Remaining Maturity Profile of Investments**. This shows the short duration of investments corresponding with the reduced interest income receivable.
- **Investments by Institution.** This expresses the investments held with different institutions as a percentage of the total. It can be seen that investments are diversified over many organisations, however 63% is invested with UK part nationalised banks.
- **Geographic Spread of Investments** as determined by the country of origin of relevant organisations. All countries are rated AA and above as per our approved criteria. The majority of investments continue to be with UK financial institutions. With strong investment flows in highly rated banks in strong countries, such banks are able to attract funding without offering high rates, and thus, exposure to non-UK institutions remains difficult.
- **Investments by Financial Sector.** The majority of investments continue to be with banks.

3.7 Whilst a difficult figure to forecast due to the uncertainty of the markets, cash flows and the number of variables that impact on the figure, the forecast level of interest receivable from treasury investments for 2013/14 is £0.4 million as included in our current projections for capital financing in the month 6 Budget Monitoring Report. The return achieved since the start of the year is 0.68% compared to the benchmark 7 day London Interbank Bid Rate (LIBID) of 0.36%.

3.8 The Council currently uses the Debt Management and Deposit Facility (DMADF) as a last resort if no alternative investment opportunities are available. The maximum rates available from the facility are 0.25%

Borrowing

4.1. Long term borrowing is undertaken to finance the Council's Capital Programme and the main sources of borrowing are the PWLB and the Money Markets.

4.2. At 31 October 2013, the Council had £453 million of external borrowing. This is predominantly made up of fixed interest rate borrowing from the PWLB payable on maturity.

31 Mar 2013			**31 Oct 2013**	
£m	**Rate (%)**		**£m**	**Rate (%)**
402.7		Debt from : PWLB	400.7	
52.0		Market	52.0	
0.7		Other	0.6	
455.4	**5.25**	**Total External Debt**	**453.3**	**5.26**

4.3 The borrowing strategy outlined in the February 2013 budget report indicated that:-

Whilst rates are likely to remain low for some time, the Council is mindful to defer any new borrowing and use internal borrowing to minimise short-term costs. However with financial markets uncertain, caution will be adopted in 2013/14, with rates monitored closely and a pragmatic approach adopted to changing circumstances which may include taking an element of borrowing at various times to secure low rates.

4.4 At the 31 March 2013, the Council's need to borrow for capital expenditure purposes, its Capital Financing Requirement (CFR), was £475 million and its external borrowing was £455 million. Accordingly there was an estimated internal borrowing requirement of £20 million. This meant that it was using short term cash flows to pay for long term capital works. The Council last borrowed externally in June 2012 when loans of £15 million were undertaken from the PWLB. No new borrowing has been undertaken to date in 2013/14 primarily as a result of the short term costs of carrying that borrowing on the Council's revenue budget.

4.6 Long term borrowing rates are significantly higher than investment income rates, accordingly the cost of undertaking any new borrowing would have a negative impact on the revenue budget. External borrowing may be deferred in order to minimise short term costs by using temporary cash balances to pay for capital expenditure however deferring borrowing is only a short term measure and could expose the Council to higher borrowing rates and costs in the future. Whilst the timing of additional borrowing is uncertain it will need to be undertaken in due course with rates being closely monitored.

4.7 Whilst the capital financing budget allows for the costs of undertaking additional borrowing, the Month 6 revenue budget monitoring position currently assumes no borrowing is undertaken in the remainder of the year. Internal borrowing at the end of this year is dependant on a number of variables including progress on implementing schemes in the capital programme and a review of the approach to the Council's Minimum Revenue Provision for the repayment of debt i.e. the amount set aside each year as a provision to repay borrowing. Coupled with forecasts of expenditure in 2013/14 on the capital programme, there will be an increase in the underlying need to borrow resulting in an estimated internal borrowing requirement of £47 million at 31 March 2014.

4.8 Annexe C shows the maturity profile of the Council's borrowing as at 31 October 2013. None of the Council's Market Loans, which are Lender Option Borrower Option Loans (LOBO's) had to be repaid during the first half of the year. However £24 million of the LOBO's are subject to the lender potentially requesting a change in the rate of interest payable every six months, which could trigger early repayment.

4.9 Unless the Council's LOBO's are required to be repaid early, very little debt matures within the next 10 years. In the medium to long term, efforts will be made to restructure loans in years with large maturities such as in 2056/57 to reduce refinancing risk and ensure a prudent profile of debt repayment.

Debt Rescheduling

5.1 No debt rescheduling or early repayment of debt has been undertaken primarily due to the higher premiums charged by the PWLB for early repayment.

Compliance with treasury limits and prudential indicators

6.1 During the financial year to date, the Council has operated within the treasury limits and prudential indicators set out in the annual Treasury Management Strategy in February 2013.

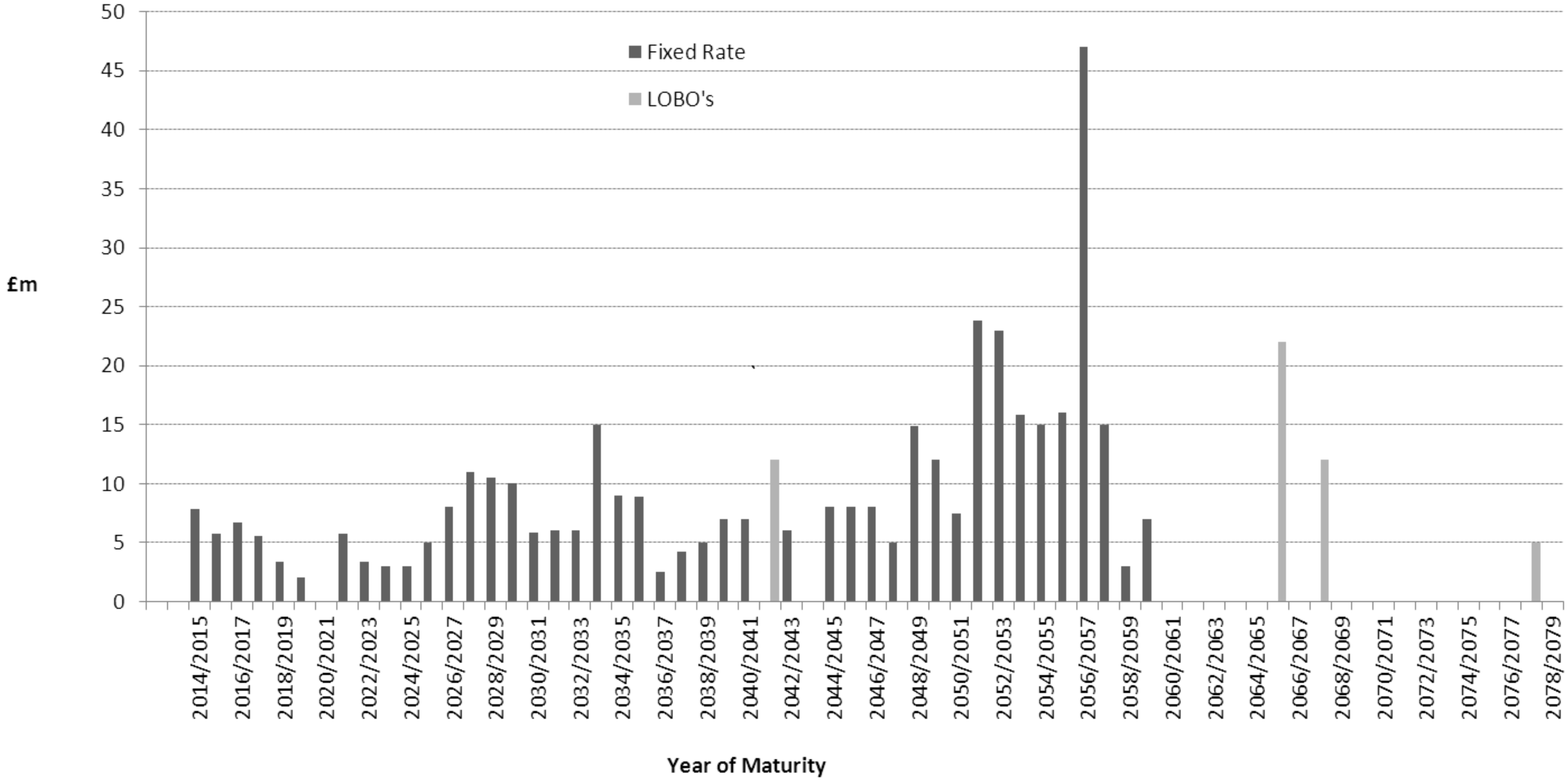
Treasury Management issues for the Remainder of 2013/14

7.1 Various issues continue to be monitored closely including the credit worthiness of counterparties, the timing of new borrowing and procurement of new banking services provider

Whilst there is no formal notification at this stage from Welsh Government, the timescales required for implementation and the requirement for UK legislation in respect of a debt cap, means Housing Finance reform is unlikely to take place until April 2015.

Annexe A – Investments at 31 October 2013
Annexe B – Investment Charts at 31 October 2013
Annexe C – Maturity Analysis of borrowing as at 31 October 2013
Annexe D – Glossary of Treasury Management terms

Maturity Profile of Debt at 31 October 2013



Annexe D

Glossary of Terms - Treasury

Bank Rate
The rate of interest set by the Bank of England as a benchmark rate for British banks.

Borrowing
Loans taken out by the authority to pay for capital expenditure or for the prudent management of the Council's financial affairs, which are repayable with interest.

Counterparty
One of the parties involved in a financial transaction.

Credit Criteria
The parameters used as a starting point in considering with whom the council may place investments, aimed at ensuring the security of the sums invested.

Credit Rating
A credit rating assesses the credit worthiness of an individual, corporation, or even a country. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the subject being able to pay back a loan. Ratings usually consist of a long term, short term, viability and support indicators. The Fitch credit rating of F1 used by the Council is designated as "Highest Credit quality" and indicates the strongest capacity for timely payment of financial commitments.

Debt Management Account Deposit Facility (DMADF)
The Debt Management Office provides this service as part of its cash management operations and of a wider series of measures designed to improve local and central government's investment framework and cash management. The key objective of the DMADF is to provide users with a flexible and secure facility to supplement their existing range of investment options while saving interest costs for central government.

Debt Restructuring
Debt restructuring is a process that allows an organisation to reduce, renegotiate and undertake replacement debt.

Diversification of Investments
The process of creating a portfolio of different types of financial instruments with regard to type, price, risk issuer, maturity, etc. in order to reduce the overall risk of the portfolio as a whole.

Duration (Maturity)
The length of time between the issue of a security and the date on which it becomes payable.

External Borrowing
Money borrowed from outside of the Council.

Fitch Credit Ratings
A commercial organisation providing an opinion on the relative ability of an entity to meet financial commitments, such as interest, preferred dividends, repayment of principal, insurance claims or counterparty obligations. The opinion is usually provided in the form of a credit rating.

Fixed Rate
An interest rate that does not change over the life of a loan or other form of credit.

Internal Borrowing
Money borrowed from within the Council, sourced from temporary internal cash balances.

Investments
The purchase of financial assets in order to receive income and/or make capital gain at a future time, however with the prime concern being security of the initial sum invested.

Lender Option Borrower Option Loans (LOBOs)
Loans to the Council where the lender can request a change in the rate of interest payable by the Council at pre-defined dates and intervals. The Council at this point has the option to repay the loan.

Liquidity
The ability of the Council to meet its financial obligations as they fall due.

Market Loans
Borrowing that is sourced from the market i.e. organisations other than the Public Works Loan Board or a Public Body.

Minimum Revenue Provision
This is the amount which must be charged to the authority's revenue account each year and set aside as provision for repaying external loans and meeting other credit liabilities. The prudent amount is determined in accordance with guidance issued by WG. This has the effect of reducing the Capital Financing Requirement (CFR).

Money Market Funds
An investment fund which pools the investments of numerous depositors, spreading those investments over a number of different products and counterparties.

Prudential Code for Capital Finance
The system introduced on 1 April 2004 by Part 1 of the Local Government Act 2003 which allows local authorities to borrow without Government consent, provided that they can afford to service the debt from their own resources and

that any such borrowing is prudent and sustainable. This requires the preparation and approval of various indicators.

Public Works Loans Board (PWLB)
The Public Works Loans Board is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

Security
Protecting investments from the risk of significant loss, either from a fall in value or from default of a counterparty.

Sovereign Credit Ratings
The credit rating of a country. It indicates the risk level of the investing environment of a country, taking into account political risk and other factors.

Specified Investments
A term defined in WG investment regulations, referring to any investments for less than one year, in sterling, and where the principal sum to be repaid at maturity is the same as the principal sum invested. An investment not meeting the above criteria would be termed a Non-specified investment

Sterling
The monetary unit of the United Kingdom (the British pound).

Term Deposits
A term deposit is a money deposit at a banking institution that cannot be withdrawn for a certain "term" or period of time.

UK Government Gilts
Fixed-interest debt securities issued or secured by the British Government. Gilts are always denominated in sterling though the Government occasionally also issues instruments in other currencies in the Eurobond market or elsewhere.

Variable Rate
An interest rate that changes periodically in line with market rates.

Yield
The annual rate of return paid out on an investment in securities, expressed as a percentage of the current market price of the relevant securities.