AGENDA ITEM NO: 4

HAMBLETON DISTRICT COUNCIL

Report To: Cabinet
3 September 2013

Subject: **2013/14 Q1 CAPITAL MONITORING AND TREASURY MANAGEMENT REPORT**

All Wards
Portfolio Holder for Support Services and Economic Development: Councillor P R Wilkinson

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1.0 PURPOSE AND BACKGOUND:

1.1 The purpose of this report is to provide Members with the Quarter 1 update at 30 June 2013 on the progress of the capital programme 2013/14 and the treasury management position. A full schedule of the capital programme 2013/14 schemes is attached at Annex A, together with the relevant update on progress of each scheme.

1.2 Capital expenditure is intrinsically linked with treasury management as the way that the capital programme is funded, directly effects the treasury management arrangements of the Council. This Council currently does not borrow for a capital purpose; instead capital expenditure is funded by grants, receipts and reserves. The use of the Council's funds affects the daily treasury management cash flow position, as well as the requirement to investment these surplus funds.

2.0 CAPITAL PROGRAMME SUMMARY:

2.1 The 2013/14 capital programme was approved by Cabinet on 19 March 2013 at £1,985,500. At 2012/13 outturn, £709,365 capital expenditure was slipped forward in the new financial year revising the capital programme 2013/14 to £2,694,865.

2.2 A net increase to the capital programme of £16,775 is detailed in this Quarter 1 monitor that results in a revised capital programme budget of £2,711,639.

2.3 The net increase of £16,775, to be approved in this report, is made up of:-
(a) increase in expenditure from re-profiling of £20,000 from 2014/15 to this year;
(b) increase in expenditure of £58,717 supported from increased grant funding;
(c) increase in expenditure of £27,965 supported from reserves;
(d) reduction in scheme expenditure of £89,907.

2.2 Table 1 below outlines the variances reported against each portfolio area.

Portfolio	Current Approved Expenditure £	Revised projected Outturn £	Variance £	Budget re-profiled from 2014/15 £	Request for additional funding £	Funding no longer required £
Customer Services and Asset Management	561,901	573,866	11,965		11,965	
Housing, Planning and Waste Management	406,910	474,555	67,645		9,000	(72)
Leisure and Health	982,800	1,002,800	20,000	20,000		
Support Services and Economic Development	743,253	660,418	(82,835)		7,000	(89,835)
Total	**2,694,864**	**2,711,639**	**16,775**	**20,000**	**27,965**	**(89,907)**

Table 1: Capital Programme Q1 2013/14

2.3 To 30 June 2013 capital expenditure of £624,032 had been incurred or committed representing 23% of the revised Quarter1 capital programme position.

2.4 The proposed changes to the Capital Programme, detailed for each of the 4 portfolio areas, are attached at Annex B.

3.0 FUNDING THE CAPITAL PROGRAMME:

3.1 The funding resources available for the ten year period from 2013/14 to 2022/23 at 31 March 2013, as included in the Statement of Accounts 2012/13, was £8,509,070. Additional capital grant income will be received over the next 10 years from Government and other contributions but the current total funding position is shown below:-

	£
Capital Receipts	4,567,306
Capital Grants	76,586
Capital Fund	3,568,175
Total 31 March 2013	8,509,070

3.2 For 2013/14, at Quarter 1, the capital programme of £2,711,639 is being funded from £408,717 external grants/contributions and £2,302,922 from reserves. At year end in accordance with accounting practice the funds will be used from the capital receipts, unapplied grants or capital fund reserves.

3.3 The position regarding spending and resources for the 10 year capital plan is as follows:-

	£
Total 10 Year Funding (as above)	8,509,070
Less: 2013/14 anticipated spend	2,711,639
	5,797,431
Less: Capital Plan spend 2014/15 - 2022/23	4,715,000
Remaining Resources	1,082,431

3.4 The overall funding position continues to be closely monitored to ensure the overall capital programme remains affordable and sustainable over the 10 year approved capital plan.

3.5 It should be noted that the report reflects the capital programme position as if approval has been agreed by Cabinet. This is detailed in the recommendations below.

4.0 TREASURY MANAGEMENT POSITION 2012/13

4.1 The Treasury Management review at quarter 1 2013/14 is attached at Annex C and provides Members with an update on the:-
(a) treasury management position;
(b) economy and interest rates;
(c) change in investment policy;
(d) investment performance;
(e) borrowing position;
(f) Compliance with prudential and treasury indicators.

5.2 The investment position at Quarter 1 was £29,820,000 with an average interest rate return of 0.44%. For surplus funds invested for 3 months or more, a return of 0.46% was achieved which was £0.08% greater than the 3 month benchmark at 0.38%.

5.3 The economic and interest rate environment is resulting in it becoming increasing difficult to place the Council's surplus funds for investment and therefore a change in the investment policy is recommended as detailed in Annex C paragraph 3. A change in Counterparty individual and group limits is suggested, along with the introduction of enhanced money market funds to assist with the diversification of the investment portfolio.

5.4 The Council remains debt free; no borrowing was taken in the first quarter of 2013/14.

5.5 The Council has operated within the treasury and prudential indicators set out at Annex E.

6.0 LINK TO COUNCIL PRIORITIES:

6.1 All schemes approved as part of the capital programme have been evaluated against key corporate priorities. Schemes are only undertaken and approved by cabinet in accordance with the Council Plan and supporting project initiation documentation.

6.2 Treasury Management supports all aspects of the Council's priorities as with good management of surplus funds, investment interest earned can be used to support Council services.

7.0 RISK ASSESSMENT:

7.1 There are two main risk associated with the capital programme and treasury management:-

Risk	Implication	Prob	Imp	Total	Preventative action
Capital budgets are not monitored, expenditure is above budget and the funding position is unknown	The Council is unable to control capital expenditure or redirect resources to priority areas	2	5	10	Continue with regular budget monitoring with regular reports to Chief Officers, Management team and Members
Treasury management investment of surplus funds occurs with unsound institutions	The value of the investment could be lost	2	5	10	Use of treasury management advisers, good investment creditworthiness rating criteria policy approved by Council and regular monitoring reporting to Members

Prob = Probability, Imp = Impact, Score range is Low = 1, High = 5

7.2 There are no risks associated with approving this report. However, the risks associated with not receiving regular monitoring reports are potentially more serious.

8.0 FINANCIAL IMPLICATIONS:

8.1 The financial implications are dealt with in the body of the report.

9.0 LEGAL IMPLICATIONS:

9.1 Treasury Management activities and the Capital programme conform to the Local Government Act 2003 and the Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice.

10.0 **<u>EQUALITY/DIVERSITY ISSUES</u>:**

10.1 The capital programme seeks to address key equality issues that affect the Council and the public. The main scheme that specifically addressed equalities in the first quarter of 2013/14 was the disabled facilities grant scheme.

11.0 **<u>RECOMMENDATIONS</u>:**

11.1 It is recommended for Cabinet to inform Council at Quarter 1 2013/14 to:-

(1) approve the net increase of £16,775 in the capital programme to £2,711,639 and the detailed capital programme attached at Annex A;

(2) approve the increase of capital expenditure of £27,965, funded from capital reserves;

(3) approve the change in the Leeming Bar Management Suite scheme to Leeming Bar Food Enterprise Centre Improvement Works;

(4) approve the decrease of capital expenditure of £89,907 and return the funding to the capital reserve;

(5) approve the use of the additional disabled facility grant £58,717 for the housing disabled facility grant works;

(6) note the Capital Funding position and available reserve to support further capital schemes at £1,082,431;

(7) agree the treasury management position and prudential indicators at Annex E;

(9) approve the change in Individual Limit for Government backed institutions to 50% of total investments or £12m per counterparty which ever is the higher;

(10) approve the change in Group limits for Government backed institutions to a group limit of 80% of fund value; and

(11) approve the inclusion of Enhanced Money Market Funds as an alternative investment for the Council's surplus funds – noting that the value of the investment could fall or rise with market fluctuations but that this risk is mitigated to some extent if treated as a long term investment.

JUSTIN IVES

Background papers: None

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Annex A

Capital Programme Schemes 2013/14 (including 2012/13 schemes B/Fwd)

Ref:	Responsible Officer	Title:	Current Approved Expenditure £	Third Party Contribution £	Cost to the Council £	Expenditure at 30/06/13	Anticipated Expenditure £	Variance	Change in Funding Taken/(Returned) to Capital Reserve	Estimated completion date	Explanation
		Housing, Planning and Waste Management									
B/Fwd	MJ	Domestic Violence Refuge	121,000	0	121,000	120,928	120,928	-72	-72		Complete
1	MJ	Purchase of bins and boxes for refuse and recycling	36,000	0	36,000	3,746	36,000			Ongoing	Order for half of the bins to be placed in July remaining to be placed in January 2014
2	MJ	Disabled Facilities Grants	183,910	100,000	83,910	46,632	242,627	58,717		Ongoing	DFG Grant Received £158,717. Q1 June - grants of £46,632 issued, waiting for invoices and a further £35,624 committed. Looking at number of referrals coming through budget should be spent by end of year.
3	MJ	Depot wash bay	18,000	0	18,000	0	18,000			30/09/2013	Work to start week commencing 15 July
4	MJ	Central depot external lighting improvements	8,000	0	8,000	0	8,000			30/09/2013	Drawings complete, work started beginning of July
5	MJ	Central depot door improvements	15,000	0	15,000	5,757	15,000			31/07/2013	Work commenced
6	MJ	Vehicle workshop adaptations	25,000	10,000	15,000	0	25,000			31/04/2013	Work commenced
	MJ	Waste and Street Scene Clocking System				0	9,000	9,000	9,000	31/03/2014	New Scheme requested at Quarter 1 2013/14
		Total Scheme Value Housing, Planning and Waste Management	**406,910**	**110,000**	**296,910**	**177,062**	**474,555**	**67,645**	**8,928**		
		Leisure and Health									
B/Fwd	DG	Pool Filters SLC & BLC	125,000		125,000	0	125,000			31/12/2013	Work scheduled to be done mid November/early December
B/Fwd	DG	Pool Tank Tiles BLC	47,039		47,039	30,474	47,039			30/09/2013	Scheme to finalise and further invoices awaited
B/Fwd & 11	DG	HLC Plant Controls & Air Handling	26,000		26,000	19,847	26,000			30/09/2013	Work ongoing
B/Fwd	DG	Combined Heat & Power Unit SLC / BLC / TSP	70,761		70,761	47,077	70,761			30/09/2013	Completed and further discussion with Supplier to finalise invoices
9	DG	Gym equipment refresh	24,000	0	24,000	0	24,000			31/03/2014	Work scheduled to be done mid November/early December
10	DG	Air conditioning - Legislative requirement Leisure	15,000	0	15,000	0	15,000			Ongoing	Work Scheduled for end of year
12	DG	Hambleton leisure centre dehumidifier	9,000	0	9,000	0	9,000			30/06/2013	Work to commence in July
13	DG	Hambleton and Stokesley leisure centres - changing room tiles	10,000	0	10,000	0	10,000			31/12/2013	Work to commence in August
14	DG	Thirsk and Sowerby leisure centre improvement scheme	250,000	160,000	90,000	0	250,000			31/12/2013	Work scheduled to be done mid November/early December. Work going out to Tender in the summer
15	DG	Bedale leisure centre improvement scheme	240,000	80,000	160,000	0	240,000			31/12/2013	Work scheduled to be done mid November/early December. Work going out to Tender in the summer
16	DG	Stokesley leisure centre improvement scheme	158,000	0	158,000	0	158,000			31/12/2013	Work scheduled to be done mid November/early December. Work going out to Tender in the summer
17	DG	Hambleton leisure centre PA system	8,000	0	8,000	0	8,000			31/12/2013	Work to commence in July
25	DG	Hambleton LC Improvement Scheme				1,735	20,000	20,000	20,000	Ongoing	Preliminary work on development of Hambleton Leisure Centre, Scheme in 2014/15 partially b/fwd into 2013/14
		Total Scheme Value Leisure and Health Services	**982,800**	**240,000**	**742,800**	**99,133**	**1,002,800**	**20,000**	**20,000**		
		Customer Services and Asset Management									
B/Fwd	MR	Car Parks - Thirsk Cobbles	76,250	0	76,250	80,105	80,105	3,855	3,855	30/06/2013	Complete - Slight Overspend - Retention will occur 14/15 £2700
B/Fwd	MR	Car Parks - Reinstatements	47,890	0	47,890	51,000	51,000	3,110	3,110	30/06/2013	Complete - Slight overspend
B/Fwd	MR	Car Parking Charges - Directional Signs	6,510	0	6,510	6,475	6,510			30/06/2013	Work Completed, potential minor fees to follow
B/Fwd & 18	MR	Adoptions - Northallerton Thurston Rd	130,037		130,037	129,490	130,037			31/07/2013	Work Completed, potential minor fees to follow
B/Fwd & 19	MR	Ellerbeck Court, Stokesley Adoption Works	73,645		73,645	0	73,645			31/08/2013	Work to commence in July
20	MR	Car Park tariff changes	15,500	0	15,500	3,017	15,500			31/07/2013	Work commenced remaining work to be started August/September
22	MR	Public lighting replacement	36,000	0	36,000	0	36,000			31/03/2014	Work waiting on Northern Power doing underground work in Sandhutton, Battersby Junction and Thimbleby, work should be completed by end of March 2014
23	MR	Public lighting energy reductions	100,000	0	100,000	0	100,000			31/03/2014	Work to commence in September
B/Fwd	SW	CCTV Control Room Upgrade	10,069	0	10,069	0	10,069			30/09/2013	Remedial work started and progressing
7	SW	CCTV control room upgrade - Wireless Network	66,000	0	66,000	0	71,000	5,000	5,000	31/03/2014	Remedial work started, increase in project costs for invaluable consultancy expenditure to ensure successful delivery of the project
		Total Scheme Customer Services and Asset Management	**561,901**	**0**	**561,901**	**270,087**	**573,866**	**11,965**	**11,965**		
		Support Services and Economic Development									
B/Fwd	SW	Thirsk New TIC	3,000	0	3,000	0	3,000			Ongoing	Retention monies - dispute with contractor to be resolved
8	SW	Leeming Bar Food Enterprise Centre Improvement Works'	12,000	0	12,000	6,390	12,000			31/01/2014	Scheme in the Leeming Bar area progressing
26	SW	Evolution Car Park Extension				0	7,000	7,000	7,000		
B/Fwd	JI	Service Applications, Software, Servers	34,253	0	34,253	304	34,253			31/03/2014	Work in progress - additional funding required from ICT underspends
24	JI	ICT Improvements / Separation from Shared Services	89,835	0	89,835	0	0	-89,835	-89,835	31/03/2014	Return £89,835 to reserve - June 2013 Cabinet Report
24	JI	ICT Committee Admin	17,900	0	17,900	0	17,900			31/03/2014	Currently tendering - will be complete by Dec 2013
24	JI	ICT Telephony Improvements	11,265	0	11,265	0	11,265			31/03/2014	Site visit planned 24th July.
24	JI	ICT Separation from Shared Services	500,000	0	500,000	36,056	500,000			31/03/2014	Currently tendering - will be complete by Dec 2013
24	JI	ICT Improvements	50,000	0	50,000	35,000	50,000			31/03/2014	Currently tendering - will be complete by Dec 2013
24	JI	ICT Desktop Replacement	25,000	0	25,000	0	25,000			31/03/2014	Work to commence in Jan 2014
		Total Scheme Value Support Services and Economic Development	**743,253**	**0**	**743,253**	**77,750**	**660,418**	**-82,835**	**-82,835**		
		Total Capital Approvals 2013/14	**2,694,864**	**350,000**	**2,344,864**	**624,032**	**2,711,639**	**16,775**	**-41,942**		

Annex B

PROPOSED CHANGES TO THE CAPITAL PROGRAMME:

1.1 The proposed changes to the capital programme, detailed for each of the portfolio areas are listed below:-

1.2 Customer Services and Asset Management – 3 schemes require increased funding at Quarter 1:-

(a) Car Parks – Thirsk Cobbles – completion of this scheme has resulted in an over spend of £3,855, a 5% increase on original budget. There may also be the requirement for retention funding in 2014/15 which will be included in the 10 year capital plan report. In 2013/14 £3,855 additional capital reserve funding is required;

(b) Car Parks – Reinstatement – works have been completed with a 6% increase on original budget of £47,890. £3,110 additional funding is required from the reserve;

It should be noted that further capital schemes in the Customer Services and Asset Management portfolio may under spend during 2013/14, with the funding being returned to the reserve. At Quarter 1 this is too soon to state.

(c) CCTV – Wireless Network – works are ongoing with an estimated increase in budget of £5,000 required, a 7.4% increase on original budget. This will allow for consultancy costs which were not included in the original budget amount. This was due to them being part of the CCTV upgrade project, where it was anticipated that these projects would originally run in tandem. This was not the case and at the end of 2012/13 £17,000 was returned to the reserve from the CCTV upgrade scheme. Permission is now sort in this report to release the £5,000 funds from reserve.

1.3 Housing Planning and Waste Management – 3 Schemes are amended as part of Quarter 1 monitoring:-

(a) Domestic Violence Refuge – This scheme has completed at £120,928 with £72 returned to the reserve;

(b) Disabled Facilities Grant (DFG) - £58,717 additional grant funding was received from the Department of Communities for Local Government (DCLG) and this will be used in accordance with the DFG programme in Housing;

(c) Waste and Street Scene Clocking System – This scheme is new to the Capital Programme and requires approval at Quarter 1, with the funding being provided from the capital reserve. Further information is available in the Project Initiation Document and the scheme will improve the efficiency in time recoding, reducing the amount of time spent on data input and removing the current checking process across three sections of the Council.

1.4 Leisure and Health – 1 scheme is re-profiled from 2014/15 to 2013/14 at Q1:-

(a) Hambleton All Weather Pitch Refurbishment - This scheme has been approved in the 10 year plan in 2014/15 at £131,000. £20,000 is being re-profiled to start development survey works on Hambleton Leisure Centre Improvement Scheme to ensure both schemes produce best value for the Council.

1.5 Support Services and Economic Development – 3 schemes have been amended at Q1:-

(a) Evolution Car park Extension - has been added to the capital programme at £7,000 to improve the parking facilities which will assist in attracting new business to the

Evolution centre, increasing revenue income. The funding for this scheme will be from the reserve;

(b) Leeming Bar Management Suite – this scheme has been renamed ‘Leeming Bar Food Enterprise Centre Improvement Works’ to incorporate a wider remit of improvement works to the Leeming Bar site rather than one specific unit. It is still expected to deliver the £21,500 savings originally stated;

(c) ICT Improvements/Separation of Shared Services – £89,835 of funding will no longer be required a for ICT schemes and will be returned to the reserve as detailed in the June 2013 cabinet report.

1.6 Capital schemes are monitored on a monthly basis and reported to Cabinet quarterly, ensuring that the majority of schemes are held within budget or reported to Council at the earliest opportunity.

1.7 New Schemes added to the capital programme all have supporting Project Initiation Documentation to ensure projects are affordable, sustainable and prudent.

ANNEX C

TREASURY MANAGEMENT POSITION 2013/14 – QUARTER 1

1.0 LEGISLATIVE REQUIREMENT:

1.1 The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, Annual and Mid-year reports, as well as quarterly updates). This report therefore ensures this Council is implementing best practice in accordance with the Code.

1.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report therefore:-

(a) updates Members on the current treasury management position; and

(b) seeks approval to change the investment strategy/policy for 2013/14 to allow further surplus funds to be invested in the Government supported institutions and their subsidiaries eg Lloyds/Bank of Scotland and Royal Bank of Scotland.

1.3 In 2013/14 the Council's treasury position (excluding finance leases) is to continue to be debt free. No borrowing has been taken during the first quarter of 2013/14.

1.6 The capital financing requirement, which is the amount of borrowing required to support the capital programme, is zero for this Council. All capital expenditure as detailed in the paragraphs above is supported from grants, contributions and reserves. The following table shows the treasury management position as at 30 June 2013:-

	30 Jun 13 £m	Rate %
Capital Financing Requirement	0	
Borrowing	0	
Investments	29.820	0.44

Table 2: Borrowing and Investment position at 30 June 2013

2.0 THE ECONOMY, INTEREST RATES AND TREASURY MANAGEMENT STRATEGY:

2.1 The economic background, interest rate forecast and summary outlook, which sets the environment in which the Council's treasury management operates is attached at Annex D.

2.2 Sector – the Council's treasury management advisors – brief forward view of the economy and interest rate position is detailed in the subsequent paragraphs.

2.3 Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets ie equities and safer bonds. Key areas of uncertainty include:-

- The potential for a significant increase in negative reactions of populaces in Eurozone countries against austerity programmes, especially in countries with very high unemployment rates eg Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- The Italian political situation is frail and unstable.
- Problems in other Eurozone heavily indebted countries could also generate safe haven flows into UK gilts.

- Monetary policy action failing to stimulate growth in western economies, especially the Eurozone and Japan.
- The potential for weak growth or recession in the UK's main trading partners - the EU and US.
- The impact of the UK Government's austerity plan in dampening confidence and growth.
- Geopolitical risks eg Syria, Iran, North Korea.

2.4 However, there is particular potential for upside risks to UK gilt yields and PWLB rates, especially for longer term PWLB rates, as follows:-

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.
- A renewed increase in investor confidence that robust world economic growth is firmly expected, together with a reduction or end of QE operations in the US, causing a flow of funds out of bonds into equities.
- A reversal of Sterling's safe-haven status on an improvement in financial stresses in the Eurozone.
- In the longer term - a reversal of QE; this could initially be implemented by allowing gilts held by the Bank to mature without reinvesting in new purchases, followed later by outright sale of gilts currently held.
- Further downgrading by credit rating agencies of the creditworthiness and credit rating of UK Government debt, consequent upon repeated failure to achieve fiscal correction targets and recovery of economic growth.

2.5 The overall balance of risks to economic recovery in the UK is now evenly weighted. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Near-term, the prospect of further QE has diminished but measures other than QE may be more favoured by Governor Carney if additional support is viewed as being required.

2.6 Given the generally weak outlook for economic growth, Sector sees the prospects for any increase in Bank Rate before 2015 as limited. Indeed, the first increase could be even further delayed if the tentative signs of growth failed to be maintained.

2.7 Indeed the new Bank of England Governor Mark Carney, in reporting the inflation report in August, has stated that he does not see interest rates rising from 0.5% before 2016. In addition the Monterey Policy committee, headed by Mark Carney, has introduced a new monitoring measure, in addition to the 2% inflation target (Consumer Prices Index). Now the monetary policy committee will not increase interest rates unless unemployment is below 7%. This target will be review on a regular monthly basis.

3.0 ANNUAL INVESTMENT STRATEGY 2013/14 – Quarter 1:

3.1 **Investment Policy** – the Council's investment policy is governed by the Department for Communities and Local Government guidance, which was implemented in the Treasury Management Strategy Statement (TMSS) for 2013/14, and includes the Annual Investment Strategy approved by Cabinet on 19 March 2013. This Policy sets out how surplus funds are invested and placed with highly credit rated financial institutions, using Sector's suggested credit-worthiness approach. This includes the use of Country sovereign credit ratings as well as individual financial institution credit ratings and Credit Default Swap (CDS) overlay information provided by Sector.

3.2 The Treasury Management Strategy Statement sets out the Council's investment priorities as being:-

- Security of capital;
- Liquidity; and
- Yield.

The Council's priority is security of its surplus funds when investing with financial institutions, followed by ensuring the right level of liquidity is available. The Council will also aim to achieve the optimum return (yield) on investments, but security is key.

3.3 The Treasury Management Strategy Statement also details the limits as to the use of individual counterparties and also group limits. This is detailed below:-

Individual Limits – These limits will be set at 30% of total investments or £3.0m per counterparty whichever is the higher. One exception to this policy is with the Debt Management Agency Deposit Facility where the policy will be an unlimited amount with this organisation due to its high level of security. This policy will remain in force during 2013/14.

Group Limits – this policy recognises that individual counterparties (banks/financial institutions etc), whilst being sound in themselves, may be part of a larger group. This brings with it added risks where parent institutions may be in difficulties. However, if the group limit was the same as the individual limit it would be too restrictive for the placing of investments when applied to our list of approved counterparties. This policy therefore sets the group limit at 60% of fund value. Individual limits for any counterparty within the group will be as stated above.

3.4 In conjunction with the Council's treasury management adviser's Sector – consideration has been given to the difficulty in placing surplus funds in the current economic environment. It is therefore proposed to revise the Investment Strategy with Council approval in this quarter 1 2013/14 report to:-

(a) change the limits on those counterparties which are backed by the Government – Bank of Scotland, Royal Bank of Scotland, Lloyds, Natwest, Ulster Bank; and

(b) introduce the use of enhanced money market funds.

3.5 Government Backed Institutions – Sectors creditworthiness rating criteria allows Government backed institutions to hold investments for periods of up to one year. This shows that these institutions are more secure than others. Therefore it is proposed that:-

Individual Limit for Government backed institutions - is set at 50% of total investments or £12m per counterparty which ever is the higher;

Group limits for Government backed institutions - is set at a group limit of 80% of fund value.

3.6 The introduction of Enhanced Money Market Funds will allow a diversified investment portfolio and the opportunity for optimum return whilst keeping surplus funds secure. It is important to note that Enhanced Money Market Funds need to be used as a medium to long term investment – 6 months to a year. This is key as Enhanced Money Market Funds have the potential in the short term to lose part of their Net Asset Value, due to the volatility of the market. Using these funds as long-term investments will help to smooth out any potential volatility in the short term.

3.7 Enhanced Money Market Funds value, therefore, can go up as well as down but the nature of them is that over the long term they will maintain their value. Enhanced Money market Funds can be recalled to the Council and the investment terminated at any time, so that as long as core cash has been invested in this product (which is not required in the short term) then the surplus funds invested should always be returned.

3.8 The return on Enhanced Money Market Funds is currently between 1% and 2% on a long term investment for a year, compared to a 1 year deposit which is currently returning 1%. The range in returns from 1% to 2% depends on the type of fund chosen and highlights the differing options available depending on the level of risk appetite and underlying assets invested in the funds.

3.9 **Investments held by the Council** - in the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs but also to seek out value available in higher interest rates in periods up to 12 months.

3.10 Investment rates available in the market have continued at historically low levels with the base rate remaining at 0.5% since March 2009. Investment rates have fallen further during the first quarter of 2013/14 as a result of the Funding for Lending Scheme introduced by the Government and described at Annex B in the economic background and Interest rate review.

3.11 The average level of funds available for investment purposes during the quarter – latest information up to 31 July 2013 - was £30,507,787. The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The Council held £26,300,000 at Quarter 1 – latest information 31 July 2013 - core cash balances for investment purposes (i.e. funds available for more than one year) and £3,520,000 cash flow movement balances. Total investment balance at 31 July 2103 was £29,820,000.

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.26%	0.26%	£12,926
3 month	0.38%	0.46%	£117,392

Table 3: Investment performance for quarter 1 – latest information 31 July 2013

3.12 The table shows that the Council monitors its core cash against 3 month LIBID – London Inter bank Investment Rates – and its cash flow investments against the 7 day rate. The Council out-performed the 3 month by 0.08% and was in line with the 7 day benchmark.

3.13 The Council's budgeted investment return for 2013/14 is £330,000. In Q1 Revenue Budget Monitoring, this has been increased by £20k to £350,000. It is a focus of the Council to maintain the level of investment interest earned in 2013/14 by taking advantage of every available opportunity, even though interest rates on investments have fallen in Q1 of 2013/14 and interest rates are estimated to remain lower than in 2012/13, interest rate volatility should enable the revised investment return target to be achieved. Performance for investments interest earned for the quarter – latest information to 31 July 2013 – is £130,319. This return for the first 4 months of 2013/14 is in line with the budget.

4.0 BORROWING 2013/14 QUARTER 1:

4.1 Sector's – the Council's treasury management advisor – 25 year Public Works Loans Board target rate for new long term borrowing for the quarter was unchanged at 4.10%, when they revised their May interest rate forecast.

4.2 The table below shows the Public Works Loans Board interest rates which were available for loans during the first quarter of 2013/14. The Public Works Loans Board is the mechanism by which the Government allows local authorities to borrow at slightly lower interest rates than are available to other institutions. Certainty rates, as detailed in the table, are interest rates available to local authorities if they inform the Government of their borrowing requirements at the beginning of the financial year and are 0.002% (or 20 basis points) below Public Works Loans Board rates. This was introduced by the Government in October 2012.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.91%	1.50%	2.51%	3.71%	3.84%
Date	02/04/2013	08/04/2013	23/04/2013	08/04/2013	08/04/2013
High	1.20%	2.31%	3.39%	4.30%	4.41%
Date	24/06/2013	24/06/2013	24/06/2013	24/06/2013	25/06/2013
Average	1.02%	1.75%	2.81%	3.95%	4.09%

Table 4: PWLB certainty rates, quarter ended 30th June 2013

4.3 **Treasury Borrowing** – the Council remains debt free and undertook no external borrowing or cash flow purposes or capital financing purposes in the first quarter of 2013/14.

4.4 **Rescheduling of Borrowing** – the Council has no debt and therefore undertook no rescheduling of debt during 2012/13.

4.5 **Repayment of Borrowing** – the Council has no external loans and therefore no repayments were necessary.

5.0 COMPLIANCE WITH PRUDENTIAL AND TREASURY INDICATORS:

5.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury management Strategy Statement by Cabinet on 19 March 2013.

5.2 During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Annex E.

ANNEX D

ECONOMIC BACKGROUND, INTEREST RATE FORECAST AND SUMMARY OUTLOOK

ECONOMIC BACKGROUND

- During the Quarter ended 30 June:-
  - Indicators suggested that the economy accelerated;
  - Stronger household spending, both on and off the high street;
  - Inflation remained stubbornly above the Monetary Policy Committee's (MPC) 2% target;
  - The MPC remained in a state of limbo ahead of Mark Carney's arrival;
  - 10-year gilt yields rose above 2.5% and the FTSE 100 fell below 6,100;
  - The Federal Reserve discussed tapering the pace of asset purchases under Quantitative Easing 3 (QE3).

- After avoiding recession in the first quarter with a 0.3% quarterly expansion, it looks likely that the economy grew even more strongly in Quarter 2. On the basis of past form, the Chartered Institute of Purchasing and Supply/Market business surveys for April and May point to 0.5% quarterly growth in the second quarter of 2013. Official output data echoed the message from the business surveys. The 3 month /3 month change in industrial production reached 0.9% in April, the strongest pace since July 2010. Similarly, the service sector expanded by 0.8% on the same basis. And while output in the volatile construction sector in April was 1% lower than a year ago, it was the smallest annual fall since the end of 2011, raising the prospect that the sector supported the recovery in Quarter 2.

- There have been signs of renewed vigour in household spending in the second quarter. May's 2.1% monthly rise in retail sales overturned April's 1.1% fall. This tallied with information from the Bank of England agents, who reported a further pick-up in retail sales values in May. Non-high street spending looks to have been robust too, with new car registrations up by 20% in the year to May.

- The pick-up in economic growth appears to have supported the labour market, with employment rising by 24,000 in the three months to April. Admittedly, this was a lot slower than the 113,000 quarterly gain in employment seen on average over the past twelve months. But the rise in employment was still strong enough to reduce the level of unemployment further. The International Labour Organisation (ILO) measure fell by 5,000 in the three months to April while the timelier claimant count measure reported an 8,600 fall in May. Meanwhile, pay growth rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the additional rate of income tax. Excluding bonuses, earnings rose by just 1.3% year/year, well below the rate of inflation at 2.7% in May.

- Meanwhile, the Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with the quoted interest rate on a 2-year fixed rate mortgage at a 90% loan-to-value ratio now 4.6%, around 130 basis-points lower in May than when the Funding for Lending Scheme (FLS) was introduced in August 2012.

- Alongside 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, as measured by the British Board of Agreement (BBA), rose from 33,000 to 36,100 in May. Excluding a stamp-duty holiday related spike in January 2012, this was the highest level for over three years. The rise in demand has helped to push up house prices, with both the Halifax and Nationwide measures reporting a 0.4% monthly gain in May. On an annual basis, measured prices were up by 3.7% and 1.1% respectively.
- 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 Quarter 2 looked to be broadly in line with last year's figures, highlighting the government's difficulty in reducing borrowing while economic growth is relatively lacklustre.
- Meanwhile, the 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan. Total expenditure was still forecast to be broadly flat in real terms in 2015/16 and the £50bn planned capital expenditure announced for that fiscal year was identical to the amount already outlined in March's Budget.
- On the monetary policy front, June's MPC meeting, the last chaired by the outgoing Governor Mervyn King, showed that the Committee remained in limbo ahead of the arrival of his replacement, Mark Carney. The Committee voted 6-3 to keep the level of asset purchases unchanged at £375bn, with the majority judging that the current stimulus and Funding for Lending Scheme (FLS) would be sufficient to support growth in the context of price stability.
- Having fallen from 2.8% to 2.4% in April, Consumer Prices Index (CPI) inflation rose to 2.7% in May. May's rise mostly reflected price changes due to the earlier timing of Easter, which depressed inflation in April. Even so, inflation is still likely to have risen further in June due to base effects, with last year's fuel price falls providing an unfavourable annual comparison. That said, underlying price pressures do seem to be easing, with wages and producer prices both growing at subdued rates. Indeed, if anything, the inflation outlook brightened over the second quarter, with the price of oil falling from $108pb to $103pb while sterling appreciated by around 1.5% on a trade-weighted basis.
- Having continued to rally over April and May, financial markets sold off in June following a Federal Reserve statement that suggested the central bank may 'taper' its asset purchases earlier than anticipated. The resulting rise in US Treasury yields was replicated in the UK, with 10 year gilt yields rising to 2.5% from 1.8% at the start of the quarter. Equities were hit too, with the FTSE 100 falling from 6,411 at the start of the quarter to below 6,100 before ending the quarter a bit higher at 6,240.
- In the US, the statement from the Fed took the limelight. The Fed's comments sparked a sharp sell-off in the Treasury market, with 10-year Treasury yields hitting 2.54%. The Fed move was a response to the improving economic outlook in the US. Indeed, payroll figures showed that the US added 175,000 new jobs in May, helping to pull the unemployment rate down to 7.6%, from 8.2% a year ago. In the housing market, house prices rose by 12% in the year to April, which helped to bring more households out of negative equity.

- Meanwhile, tensions in the Eurozone eased over the second quarter, but there remained a number of triggers for a potential flare-up. For example, the Democratic Left party left the Greek governing coalition in June, causing 10 year Greek government bond yields to surge to 11.5% from around 8% a month ago. And while the economic survey data improved consistently over the first half of the year, the composite Eurozone PMI is still pointing to a further contraction in output in Quarter 2. If this materialises, it would be the seventh quarter of Eurozone recession, the longest on record.

INTEREST RATE FORECAST

The Council's treasury advisor, Sector, has provided the following forecast:-

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%
5yr PWLB rate	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%	2.40%
10yr PWLB rate	2.90%	2.90%	3.00%	3.10%	3.20%	3.30%	3.50%
25yr PWLB rate	4.10%	4.10%	4.20%	4.20%	4.30%	4.40%	4.60%
50yr PWLB rate	4.20%	4.20%	4.40%	4.40%	4.50%	4.60%	4.70%

Sector undertook a review of its interest rate forecasts following the issue of the latest Bank of England Inflation Report in May 2013. Sector has left unchanged its forecast for the first increase in Bank Rate to be in March 2015. However, forecasts for PWLB rates have been increased as a result of the marked recovery in confidence in equity markets, anticipating stronger economic recovery in America, supported by growth in the Far East. The rise in equity prices was dented towards the end of the quarter by comments from Ben Bernanke, chairman of the Federal Reserve, that quantitative easing (QE) 3 would be tapered off in the not too distant future. This seemed to catch financial markets by surprise and generated a bit of a stampede out of bonds and equities. This sharp sell off in bonds caused ten year bond yields to jump up nearly 90 basis points between the low and high for the quarter.

SUMMARY OUTLOOK

UK economy

In Mervyn King's last Inflation Report as Governor of the Bank of England, there was a distinct shift towards optimism in terms of a marginal upgrading of growth forecasts so that the wording changed for the recovery from “remain weak by historical standards” to “modest and sustained recovery over the next three years”. In addition, there was a lowering of the inflation forecast to now hit the 2% target within two years. However, this is still a long way away from strong recovery though the chances of there being more quantitative easing (QE) have receded due to business surveys indicating that the economy is on the up. Quantitative easing (QE) has not increased from a total of £375bn since October 2012 and other measures have been implemented in preference to further quantitative easing (QE). Thus the Funding for Lending Scheme (FLS), (started in August 2012), was expanded in April to provide further incentive to banks to expand lending to small and medium size enterprises. The Funding for Lending Scheme (FLS) certainly seems to be having a positive effect in terms of stimulating house purchases (though levels are still far below the pre crisis level), and a marginal increase in house prices. However, concerns are increasing that quantitative easing (QE) and Funding for Lending Scheme (FLS) are also in danger of causing asset price bubbles. Investors may seek higher returns by switching investment of cash from deposit accounts (yielding very low rates) and from government and corporate bonds - ahead of the eventual end of quantitative easing (QE) - to equities, whilst Funding for Lending Scheme (FLS) may have the side effect of inflating house prices, creating the potential for prices in each of these markets to be pushed at some point in time to potentially unsustainable levels.

In summary, our current views are centred around the following:-

UK

- Mark Carney started on 1 July as the new Governor of the Bank of England. His appointment could lead to some changes to the way the Monetary Policy Committee (MPC) operates and makes decisions and announcements. It is possible there could be forward guidance e.g. that Bank Rate will not go up until some target rate, e.g. unemployment, had fallen to a specified level. Some commentators are guessing that this could effectively close the door to any increase in Bank Rate until sometime in 2016;
- Growth in Quarter 1 of 2013 was confirmed at +0.3%. Quarter 2 looks likely to be even higher at around +0.5%. The so called double dip recession at the beginning of 2012 was erased by the latest revision of statistics;
- Business surveys, consumer confidence, consumer borrowing and house prices are all on the up and may help to create a wide spread feel good factor. But this is still a long way away from the UK getting back to strong growth;
- A fair proportion of UK Gross Domestic Product (GDP) is dependent on overseas trade; the high correlation of UK growth to US and EU Gross Domestic Product (GDP) growth means that the UK economy is likely to register growth rates below the long term average in 2013 and 2014, though this should be on an improving trend;
- Consumers are likely to remain focused on paying down debt and consumer expenditure is likely to remain suppressed by inflation being higher than increases in average earnings i.e. disposable income will continue to be eroded;
- The Coalition government is hampered in promoting growth by the need to tackle the budget deficit. However, the March budget did contain measures to boost house building and the supply of mortgages, and brought forward, by one year to April 2014, the start of a £10,000 tax free allowance for incomes;
- Little sign of a co-ordinated strategy for the private sector to finance a major expansion of infrastructure investment to boost UK growth;
- Government inspired measures to increase the supply of credit to small and medium enterprises (which are key to achieving stronger growth) by banks are not succeeding;
- There is little potential for more quantitative easing (QE) in 2013 in the UK and so gilt yields are vulnerable to pressures to rise, especially as gilt yields are powerfully influenced by American treasury yields and American investors have been spooked by Bernanke's comments on tapering quantitative easing (QE) in America;
- In February 2013 Moody's downgraded the UK's AAA credit rating one notch to AA+ and Fitch followed suit in April. There was little reaction in financial markets, as this had been widely anticipated.

Eurozone

- Most Eurozone countries are now battling against recession, although Germany is experiencing a resurgence of business confidence and surveys are pointing towards a resumption of growth. Growth prospects for many Eurozone countries are poor due to the need to adopt austerity programmes to bring government deficits under control;

- The ECB cut its central rate from 0.75% to 0.5% in this quarter but this is unlikely to lead to much in the way of improvement in the prospects for Gross Domestic product (GDP) growth;

- Although market anxiety about Greece has subsided after the agreement to a further major financial support package amounting to nearly €50bn in December. In addition, business surveys are indicating some improvement in the economy, concerns are building that yet another haircut to reduce total debt to a more manageable level will eventually be required, together with more bail out funds. Whether all parties to such a deal would be prepared to pour more money into Greece remains an open question. The eventual end game could therefore still be that Greece is eventually forced to exit (dubbed "Grexit") the Eurozone and to return to the Drachma;

- There is also increasing concern that the contraction in Spain's economy and the very high level of unemployment of 27%, similar to the level in Greece and Portugal, could mean that all three countries could get into a downward deflationary spiral, which makes achieving fiscal correction increasingly difficult and possibly unachievable. The ECB's pledge to provide unlimited bond buying support for countries that request an official bailout means that market anxiety about these countries is likely to be subdued in the immediate future. However, the poor economic fundamentals and outlook for these economies could well mean that a storm in financial markets has only been delayed, not cancelled. Spain has resisted asking for an official national bailout, although it has received financial support to recapitalise its four largest banks;

- The general election in Italy has created a highly unstable political situation where the two dominant parties have formed an unlikely coalition due to the blocking power of the new upstart Five Star anti-austerity party which has 25% of seats and has refused to enter a coalition agreement with ANY party. Whether such a coalition could effectively implement an agreed policy of austerity is very much open to question – which will make Italy vulnerable to swings in investor confidence;

- There could therefore be volatility in Spanish and Italian bond yields over the next year, depending on political and economic developments;

- A general election is due in Germany in the autumn of 2013. It currently looks likely that this will lead to little change in current policy on the Euro and support for peripheral countries. However, polls are indicating that 25% of the electorate now favour Germany leaving the Euro and stopping the flow of money from Germany to profligate southern countries. Any further disasters in the Eurozone could see this sentiment increase significantly;

- A bailout for Cyprus was eventually agreed in the last week of March. Slovenia, however, looks increasingly likely to be the next in line for a bailout, so their bond yields have risen. However, huge damage will be done to the Cypriot economy by the fallout from this bailout and many commentators consider it is only a matter of time before another bailout will be needed – or exit from the Euro;

- There are also concerns about the way austerity programmes are affecting economic growth in Ireland and Portugal. The Eurozone remains particularly vulnerable to investor fears of contagion if one country gets into major difficulty. Chancellor Merkel will be hoping that no major blow up occurs before the German general election which requires Germany to pour yet more money into a floundering country.

US

- There has been a marked improvement in consumer, investor and business confidence this year.
- Unemployment has continued on a steady, but unspectacular decline to 7.6%, but still a long way from the target rate of 6.5% for an increase in the Fed. rate.
- The housing market has turned a corner, both in rising price rises and the volume of house sales. Many householders are now not in negative equity.

- US equities reached all time highs, and so added to the feel good factor, until Ben Bernanke's words on tapering quantitative easing (QE3) spooked investors.
- There has been a strong resurgence of confidence in US financial markets due to the "fiscal cliff" being largely averted or postponed. However, tax increases and cuts in Government expenditure leading to cuts in jobs, are damping the potential for recovery in growth rates.
- Gross Domestic product (GDP) in Quarter 1 was disappointingly downgraded from +2.4% to a sub par +1.8%.
- The shale gas revolution is providing some solid underpinning to the US economy by enhancing its international competitiveness through cheap costs of fuel.
- There has been a start to the re-homing of manufacturing production from China to the USA as Chinese labour costs have continued their inexorable rise and new forms of high tech production have made home based production more viable and flexible.

China

- GDP growth has been disappointing in 2013. There are still concerns around an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector.
- There are also increasing concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates during the Government promoted expansion of credit, aimed at protecting the overall rate of growth in the economy since the Lehmans crisis.
- Since the change of national leadership, the new leaders have taken action to test the robustness of the banking system which has caused a rise in fear that there could be a credit crunch looming up in China.

Japan

- The initial euphoria generated by "Abenomics", the huge quantative easing (QE) operation instituted by the Japanese government to buy Japanese debt, has quickly evaporated as the follow through measures to reform the financial system and introduce other economic reforms, appears to have stalled.

Annex E

Prudential and Treasury Management Indicators

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy Statement by Cabinet on 19 March 2013

The main purpose of the indicators is to control how much a Council needs to borrow and as this Council is debt free, the majority of the prudential indicators are nil.

1. PRUDENTIAL INDICATORS	**2013/14**	**2013/14**
Extract from budget and rent setting report	**Original Budget**	**Actual Q1**
	£'000	**£'000**
Capital Expenditure	1,907	2,702
Ratio of financing costs to net revenue stream	N/A	N/A
Net borrowing requirement General Fund		
brought forward 1 April	Nil	Nil
carried forward 31 March	Nil	Nil
in year borrowing requirement	Nil	Nil
Capital Financing Requirement 31 March 2103	Nil	Nil
Incremental impact of capital investment decisions	£	£
Increase in Council Tax (band D) per annum	£5.28	£5.28

2. TREASURY MANAGEMENT INDICATORS	**2013/14**	**2013/14**
	original	**actual**
	£'000	**£'000**
Authorised Limit for external debt -		
borrowing	£5,000	£5,000
other long term liabilities	£1,000	£1,000
TOTAL	£6,000	£6,000
Operational Boundary for external debt -		
borrowing	£4,000	£4,000
other long term liabilities	£600	£600
TOTAL	£4,600	£4,600
Actual external debt	£0	£0
Upper limit for fixed interest rate exposure		
Net principal re fixed rate borrowing / investments	Nil	Nil
Upper limit for variable rate exposure		
Net principal re variable rate borrowing / investments OR:-	Nil	Nil
Upper limit for total principal sums invested for over 364 days (per maturity date)	£11,500	£11,500

Maturity structure of fixed rate borrowing during 2012/13	upper limit	lower limit
under 12 months	0%	0%
12 months and within 24 months	0%	0%
24 months and within 5 years	0%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%