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Report of Deputy Chief Executive

Report to Executive Board

Date: 19th November 2014

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2014/15

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	☐ Yes	☒ No
Are there implications for equality and diversity and cohesion and integration?	☐ Yes	☒ No
Is the decision eligible for Call-In?	☒ Yes	☐ No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	☐ Yes	☒ No

Summary of main issues

1. This report provides a review and update of the treasury management strategy for 2014/15.

2. The Council's level of external debt as at 31st March 2015 is anticipated to be £1,443m, £102m lower than approved in February 2014. This lower forecast borrowing requirement is as a result of a review of the capital programme and higher revenue balances than anticipated which have been used in lieu of external borrowing. The level of debt is expected to remain within the Authorised Limit for external debt as agreed by Council on 14th February 2014.

3. Monitoring of money and financial markets has resulted in forecast revenue savings of £1.1m. This saving is largely due to continuing to fund the borrowing requirement from short term loans at historic low rates and internal cash balances.

4. The investment of surplus monies will continue to have due regard for security of capital in accordance with the Council's approved investment strategy.

Recommendations

5. That the Executive Board note the update on the Treasury Management borrowing and investment strategy for 2014/15.

1 Purpose of this report

1.1 The 2014/15 treasury management strategy was approved by Executive Board on 14th February 2014. This report provides a review and update of the strategy for 2014/15.

2 Background information

2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities (amended 2009 and 2011) in particular:

- The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of prudential indicators.
- Any in year revision of these limits must be set by Council.
- Policy statements are prepared for approval by the Council at least three times a year.

3 Main issues

3.1 Review of Strategy 2014/15

3.1.1 The current borrowing forecasts are shown in Table 1

Table 1

ANALYSIS OF BORROWING 2013/2014		2014/15 Feb 14 Report £m	2014/15 This Report £m
Net Borrowing at 1 April		1,490	**1,393**
New Borrowing for the Capital Programme – Non HRA		131	**110**
New Borrowing for the Capital Programme – HRA		0	**0**
Debt redemption costs charged to Revenue (Incl HRA)		(48)	**(47)**
Reduced/(Increased) level of Revenue Balances		(28)	**(13)**
Net Borrowing at 31 March*		1,545	**1,443**
Capital Financing Requirement			**1,838**
* Comprised as follows			
Long term borrowing	Fixed	1,404	**1,297**
	Variable (less than 1 Year)	110	**50**
	New Borrowing	55	**50**
Short term Borrowing		0	**63**
Total External Borrowing		1,569	**1,460**
Less Investments		24	**17**
Net External Borrowing		1,545	**1,443**
% borrowing funded by short term and variable rate loans		11%	**11%**

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing PFI and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes. The above reflects only the borrowing element of the CFR

3.1.2 Table 1 above shows that 2013/14 net external borrowing is now forecast at £1,443m, £102m lower than in the report to Executive Board on 14th February 2014. This lower forecast borrowing requirement is as a result of a review of the capital programme and higher revenue balances than anticipated which have been used in lieu of external borrowing. The review of and update of the capital programme is considered in the half year update on the capital programme elsewhere on the agenda.

3.1.3 The recovery which began to gather pace in 2013/14 has probably peaked in 2014/15 and is likely to marginally slacken in 2015/16. Currently GDP growth is running at 3.2% annualised following several successive quarters of good growth however headwinds are now beginning to be felt. Un-employment continues to fall and is now below 2 million yet labour productivity remains subdued and is still around 2008 levels. This points to slack remaining in the economy and it remains a key indicator in the Bank of England's Monetary Policy Committee (MPC) view on the timing and magnitude of future rate rises. A key concern for the UK economy is to rebalance the economy away from the consumer and towards exports as the growth in household income as measured by wage inflation is and remains stubbornly below inflation rates.

3.1.4 Strong growth has had an impact on government debt forecasts reducing these by £73bn as announced in the 2013 Autumn statement and a further £24bn in March 2014 budget however monthly public sector deficit figures have so far disappointed in 2014/15 . The UK Bank Rate remained at 0.5% and quantitative easing also stayed at £375bn. In October, the MPC forward guidance has changed emphasis and is not geared solely towards unemployment but to a broad basket of 18 indicators all aimed at determining how much slack remains in the economy.

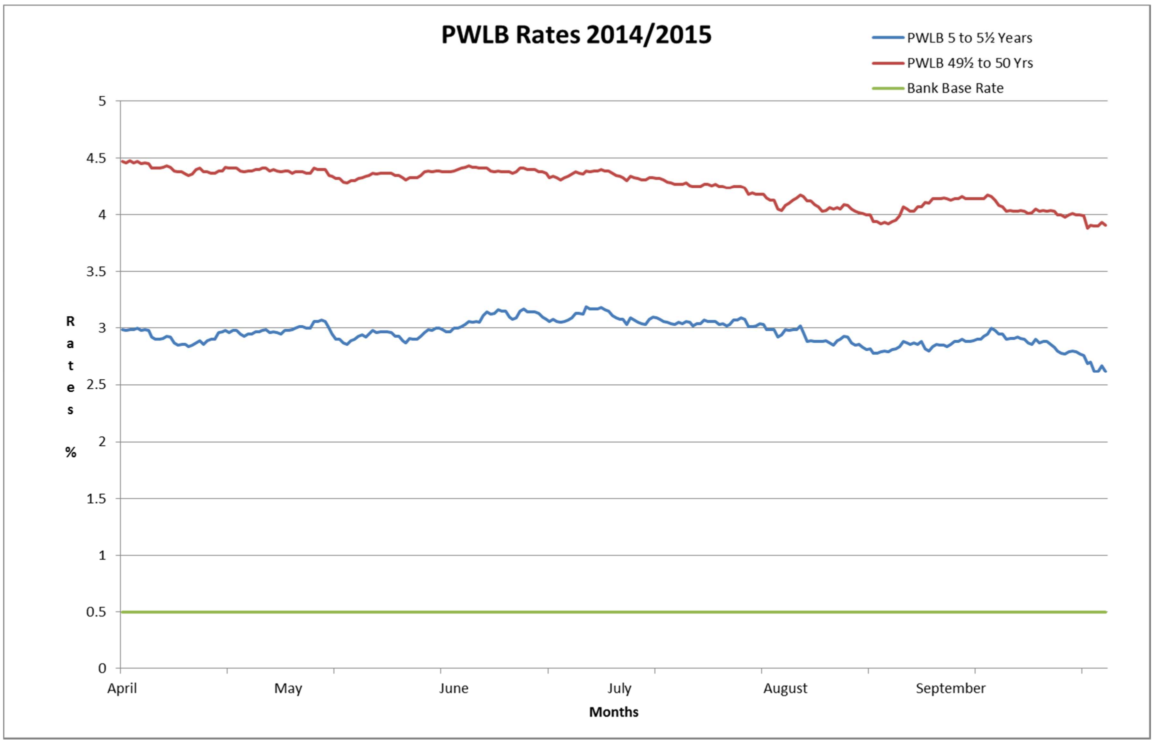
3.1.5 In the US the Federal Reserve asset purchases continue to be reduced on a monthly basis and the former $85bn of monthly purchases is likely to cease entirely in October 2014. Japan's economy remains weak with both consumer expenditure and growth now at (minus) -7.1% annualised. China's economy continues to grow at close to the target of 7.5% annualised although concerns continue to linger around the creditworthiness of bank lending to corporates and local government in the period post 2008.

3.1.6 The Eurozone continues to edge towards a deflationary spiral with average inflation for the region approaching 0% and individual economies actually having negative inflation rates. The European Central Bank has responded by cutting the benchmark rate to 0.05% and the deposit rate to (minus) -0.2% as well as instigating a program of corporate debt purchases, full QE may be imminent although the German position on this is unclear. The ghost of sovereign debt issues remains particularly for southern EU nations and this therefore remains a concern.

3.1.7 Overall risks to economic recovery in the UK is weighted to the downside as headwinds both domestic and internationally remain. Ukraine, Middle East tensions are of concern as is the prospect of weaker growth in UK, US and China all remain drivers of safe haven flows. The lack of action on addressing Eurozone Sovereign debt issues, and the unpopularity of austerity programmes in parts of Europe notable in Italy remain big unanswered question marks. The recapitalisation of European banks continues and soon to be announced stress tests will be instructive as to how this process is progressing. The forecast for the first rise in interest rates continues to be HY1 2015 however this is subject to increasing uncertainty as headwinds continue to strengthen. Many of these headwinds will also affect the forecast for gilts and therefore PWLB rates and recent news has had the effect of driving down Gilt yields to 18 month lows.

3.1.8 Chart 1 shows how the cost of longer term borrowing from the Government through PWLB loans has performed since the start of the financial year. The 5 year to 5½ Year PWLB has moved upwards from 2.99% at the start of the year to a high of 3.17% in July before falling back to the current low of 2.62%. Similarly, the 49½-50 year PWLB has moved from a high of 4.46% to 3.91% now. The Council is entitled to a reduction of 20bp on all PWLB rates reflecting eligibility for PWLB certainty rates.

Chart 1



3.1.9 Given the weaker outlook for economic growth, the prospects for any interest rate changes before early 2015 are limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints. The latest forecast of rates is shown in the following table.

Table 2

	NOW	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
BANK RATE	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.75	2.00	2.00
3 month LIBID	0.50	0.50	0.60	0.80	0.80	1.10	1.10	1.30	1.40	1.60	1.90	2.10	2.25
6 month LIBID	0.58	0.60	0.80	0.90	1.00	1.15	1.20	1.40	1.50	1.80	2.00	2.20	2.30
12 month LIBID	0.80	0.80	1.00	1.00	1.20	1.30	1.40	1.70	1.80	2.10	2.20	2.30	2.40
5 yr PWLB	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.50
10 yr PWLB	3.30	3.40	3.50	3.60	3.70	3.80	3.90	4.00	4.10	4.10	4.20	4.30	4.30
25 yr PWLB	3.90	4.00	4.10	4.20	4.30	4.40	4.50	4.60	4.70	4.80	4.80	4.90	4.90
50 yr PWLB	3.90	4.00	4.10	4.20	4.30	4.40	4.50	4.60	4.70	4.80	4.80	4.90	4.90

3.1.10 Expectations for the first change in Bank Rate in the UK are now dependent on an interpretation of how much excess capacity the MPC determines is in the economy based on a range of indicators and this now forms the basis of forward guidance from the MPC.

3.1.11 The current borrowing strategy continues to fund the borrowing requirement of the capital programme from short dated loans and internal cash balances. There will come a point when rates begin to rise and more expensive longer dated funding will be required, even though this continues to be pushed further back as the economic outlook weakens. No new long term loans have been acquired. The Deputy Chief Executive will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time.

3.1.12 The strategy of defraying long term borrowing will increase the amount of debt that the Council is funding from short term loans and its balance sheet to a forecast £505m. This exposure is considered manageable given historical capital programme slippage, the continued strength of the Council's balance sheet and the market for supplying short term funds remaining strong. These factors will continue to be monitored and should be considered in the context of the stability of the current debt maturity profile.

3.1.13 The Council's current long term debt of £1.347bn has an average maturity of nearly 39 years if all its debt runs to maturity. Approximately 33% of the Councils debt has options for repayment, in the unlikely event that all these options were exercised at the next option date then the average maturity of long term debt would be lowered to nearly 22 years. This compares favourably with the average maturity of the UK's government debt portfolio of just less than 15 years. The existing profile of the Council's debt provides considerable certainty of funding costs. Prudential indicator 16 in Appendix A shows the maturity profile of the Council's long term fixed debt and highlights that 55% or £687m matures in periods greater than 10 years.

3.1.14 Short term debt at low rates of interest and existing revenue balances continue to be used to fund the borrowing requirement which has resulted in forecast savings of £1.1m.

3.2 Borrowing Limits for 2014/15, 2015/16 and 2016/17

3.2.1 The Council is required to set various limits for 2014/15, 2015/16 and 2016/17 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code (as amended 2009 and 2011). These limits including prudential indicators are detailed in Appendix A.

3.2.2 Borrowing limits for 2014/15 were approved by Council on 15th February 2014 and remain unchanged. It is anticipated that the authority will continue to remain within the Authorised Limits for 2014/15. Both the Authorised Limit and Operational Boundary are made up of a limit for borrowing and one for other long term liabilities and the Deputy Chief Executive has authority, under the Prudential Code, to vary these two elements within the overall limits. Current performance against borrowing limits is shown in Appendix B.

3.3 Investment Strategy & Limits

3.3.1 The Council's external debt is reduced by the availability of revenue balances. The Treasury policy also allows for the external investment of these balances at advantageous rates but with due regard for security of capital invested. At present the Council's surplus monies continue to be held in short periods until required. As market sentiment to counter-party risk improves, together with enhanced returns surplus monies will be invested in accordance with the approved lending list. This lending list is based upon the assessment of the financial standing of counterparties as determined by international credit rating agencies and further refined and updated by the Council's advisors on a continual basis. The lending list is often further restricted based upon the Council's own view of the credit worthiness of counter-parties.

3.3.2 The investment strategy, as re-affirmed by Executive Board and full Council in February, allows for the Council to invest in only the most highly rated financial institutions around the world. The Council will only lend up to a maximum of £15m to financial institutions that are rated as excellent. There is also a limit of £5m for financial institutions that are rated as very good.

4 Corporate Considerations

4.1 Consultation and Engagement

4.1.1 This report is an update on strategy as presented to Executive Board in February 2014, as such no consultation has taken place. However, consultation with the Council's treasury advisors takes place regularly throughout the year.

4.1.2 The borrowing requirement is an outcome of the capital programme. Consultation is undertaken by individual services in relation to capital investment schemes. A capital programme update report is included elsewhere on this agenda.

4.2 Equality and Diversity / Cohesion and Integration

4.2.1 Equality, diversity, cohesion and integration requirements are addressed as part of individual capital scheme and programme approvals. The borrowing to deliver these capital schemes is executed through treasury strategy and as such there are no further equality diversity cohesion and integration issues.

4.3 Council Policies and City Priorities

4.3.1 Treasury Management strategy secures funding to support the Council's Policies and City Priorities as set out in the Council capital programme and is consistent with the Council's business plan.

4.4 Resources and Value for Money

4.4.1 This update on the treasury strategy recognises the borrowing necessary to fund the capital programme requirements of both General Fund and HRA. Where borrowing is supported the revenue costs are met by the Government, whilst for unsupported borrowing revenue costs are met either by the General Fund or HRA.

4.4.2 The updated strategy 2014/15 is forecast to deliver savings of £1.1m against the budgeted position.

4.5 Legal Implications, Access to Information and Call In

4.5.1 There are no legal, or access to information issues arising from this report. The report is subject to call in.

4.6 Risk Management

4.6.1 This report sets out the framework for the treasury strategy for the year ahead. The execution of strategy and associated risks are kept under regular review through:

- Monthly reports to the Finance Performance Group
- Quarterly strategy meeting with the Deputy Chief Executive and the Council's treasury advisors

- Regular market, economic and financial instrument updates and access to real time market information
- Treasury management meetings with the Core Cities and West Yorkshire Districts.

5 Conclusions

5.1 The Council's level of external debt at 31st March 2015 is anticipated to be £1,443m, £102m lower than expectations in February 2014.

5.2 Treasury Management activity has enabled revenue savings of £1.1m. This is largely due to funding the Council's borrowing requirement from short-term loans at historic low rates and internal cash balances, in lieu of more expensive longer term funding at much higher rates.

5.3 It is anticipated that the authority will remain within the approved limits for 2014/15 as outlined in Table 4 and paragraph 3.2.2.

6 **Recommendations**

6.1 Executive Board are asked to note the update on Treasury Management borrowing and investment strategy for 2014/15.

7 Background documents[1]

7.1 None

[1] The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.

Appendix A

Leeds City Council - Prudential Indicators 2014/15 - 2016/17

No.	PRUDENTIAL INDICATOR	2014/15	2015/16	2016/17
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note1)	13.16%	13.69%	14.67%
2	HRA	12.61%	11.76%	11.22%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	15.35	60.31	102.47
4	increase in housing rent per week	0.00	0.00	10.27
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
	Estimate of total capital expenditure			
6	Non HRA	256,954	238,295	173,127
7	HRA	75,854	94,704	96,630
	TOTAL	332,808	332,999	269,757
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	1,601,341	1,795,458	1,839,419
9	HRA	786,702	820,260	838,526
	TOTAL	2,388,043	2,615,718	2,677,945
9a	**Limit of HRA Indebtedness as implemented under self financing**	721,327	721,327	721,327

No.	PRUDENTIAL INDICATOR	2014/15	2015/16	2016/17
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 5)**			
	borrowing	1,900,000	1,900,000	1,900,000
	other long term liabilities	700,000	700,000	700,000
	TOTAL	2,600,000	2,600,000	2,600,000
11	**Operational boundary - (Note 5)**			
	borrowing	1,760,000	1,760,000	1,760,000
	other long term liabilities	665,000	665,000	665,000
	TOTAL	2,425,000	2,425,000	2,425,000
14	**Upper limit for fixed interest rate exposure**			
	expressed as either:-			
	Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
	Net interest re fixed rate borrowing / investments			
15	**Upper limit for variable rate exposure**			
	expressed as either:-			
	Net principal re variable rate borrowing / investments OR:-	40%	40%	40%
	Net interest re variable rate borrowing / investments			
17	**Upper limit for total principal sums invested for over 364 days (Note 5**	150,000	150,000	150,000
	(per maturity date)			
18	**Net Debt as a percentage of Gross debt**	99%	100%	100%

16	Maturity structure of fixed rate borrowing as at 31/03/2015	Lower Limit	Cumulative Upper Limit	Projected 31/03/2015
	under 12 months	0%	15%	0.71%
	12 months and within 24 months	0%	20%	8.39%
	24 months and within 5 years	0%	35%	24.48%
	5 years and within 10 years	0%	40%	10.86%
	10 years and within 20 years			3.54%
	20 years and within 30 years			0.00%
	30 years and within 40 years	25%	90%	24.19%
	40 years and within 50 years			27.82%
	50 years and above			0.00%
				100%

Notes.

1 **The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.**

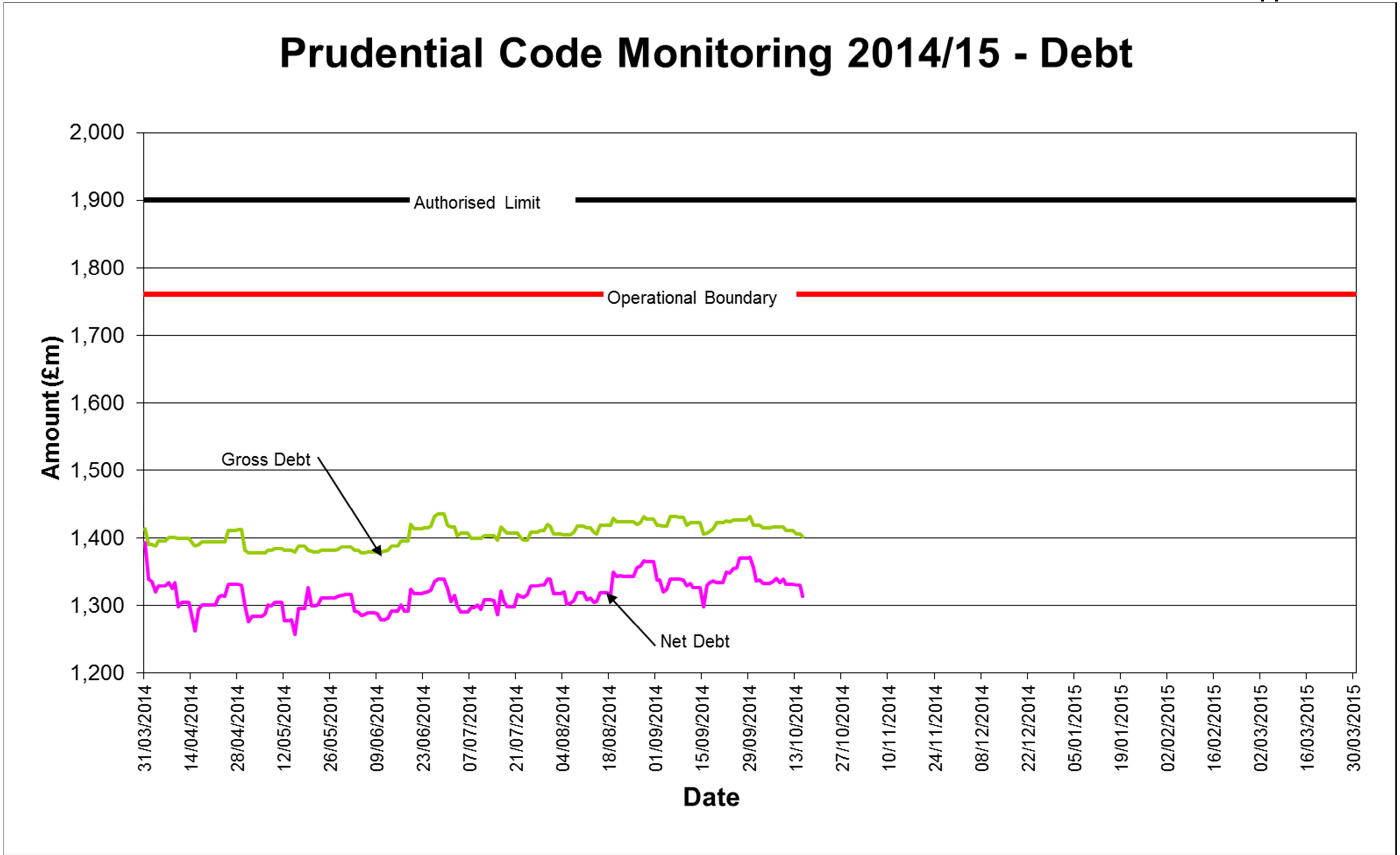
2 **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.**

3 **In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.**

4 **Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.**

5 **Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003, and the revised code in Frebruary 2010 and 2012**

Appendix B



Prudential Code Monitoring 2014/15 - Debt
2,000
1,900
1,800
1,700
1,600
1,500
1,400
1,300
1,200
Amount (£m)
Authorised Limit
Operational Boundary
Gross Debt
Net Debt
31/03/2014
14/04/2014
28/04/2014
12/05/2014
26/05/2014
09/06/2014
23/06/2014
07/07/2014
21/07/2014
04/08/2014
18/08/2014
01/09/2014
15/09/2014
29/09/2014
13/10/2014
27/10/2014
10/11/2014
24/11/2014
08/12/2014
22/12/2014
05/01/2015
19/01/2015
02/02/2015
16/02/2015
02/03/2015
16/03/2015
30/03/2015
Date