Division(s):

CABINET – 26 November 2013

TREASURY MANAGEMENT MID-TERM REVIEW 2013/14

Report by Chief Finance Officer

Introduction

1. The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice on Treasury Management (Revised) 2011 recommends that members are informed of Treasury Management activities at least twice a year. This report ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

2. The following annexes are attached

Annex 1	Lending List Changes
Annex 2	Debt Financing 2013/14
Annex 3	PWLB Debt Maturing
Annex 4	Prudential Indicator Monitoring
Annex 5	Arlingclose Quarter 2 Benchmarking

Strategy 2013/14

3. The approved Treasury Management Strategy for 2013/14 was based on an average base rate forecast of 0.50%.

4. The Strategy for Long Term Borrowing was to use internal balances up the value of 25% of the investment portfolio.

5. The Strategy included the continued use of the services of external fund manager Investec and of pooled fund vehicles with variable net asset value.

Economic Background

6. The UK economy showed some improvement, with consumer spending boosting growth. Gross Domestic Product (GDP) for the first quarter of 2013 was revised up to +0.4% and was +0.7% for the second quarter and +0.8% for the third quarter. An even stronger figure is anticipated in the final quarter on the back of strong economic indicator data releases. Revisions by the Office of National Statistics to previous GDP data showed the UK avoided a double-dip recession in 2012, but that the downturn in 2008/09 was deeper than previously estimated.

7. Annual CPI for September was 2.7% marginally down from 2.8% for March 2013. Inflation is expected to remain close to this level throughout the autumn. Further out, inflation should fall back towards the 2% target as external price pressures fade and a revival in productivity growth from the spare capacity created during the recession curbs domestic cost pressures.

8. There was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.5% and £375bn respectively. Mark Carney took over as Governor of the Bank of England in July 2013 and soon after implemented forward guidance. Within the August Inflation Report, the Bank released its forward guidance, the main element of which is to defer monetary tightening at least until the Unemployment Rate falls to a threshold of 7% (among a raft of caveats). The Bank projected that the probability of this happening would remain below 50% until 2016. The unemployment rate currently stands at 7.7% The Governor has had to defend the Bank's guidance in the face of rising financial market expectations of an earlier rate rise on the back of the encouraging economic data.

9. In April the Fitch credit rating agency downgraded the UK credit rating one notch from AAA to AA+ becoming the second of the three major credit agencies to do so. Yields on 10 year UK Government Gilts have picked up from 1.77% to 2.72% between March 2013 and September 2013. Money market rates fell over the six month period by between 0.2% and 0.6% for one to 12 month maturities. In response to these lower rates the Council has seen the rates offered on its call account reduced, in addition to lower yields on Money Market Funds and lower rates for fixed term deposits.

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

11. Whilst the outlook for the global economy appeared to have improved over the first half of calendar 2013/14, significant economic risks remain, particularly in China and the Eurozone. The Chinese banking system is facing tighter liquidity conditions as officials seek to slow down rampant credit growth, and, despite the time gained by the European Central Bank to allow individual members and the Eurozone as a whole to reform their economies, the Eurozone debt crisis has not gone away. The US recovery appeared to be in train, but a lack of agreement on the federal budget by the end of September caused a partial government shutdown at the start of October. There was also fierce debate regarding the US debt ceiling. A deal was eventually reached although this only funds the Government to 15 January and extends the Treasury's borrowing authority to 7 February when another round of political brinksmanship is anticipated.

Treasury Management Activity

Debt Financing

12. Oxfordshire County Council's debt financing to date for 2013/14 is analysed in Annex 2.

13. The 2013/14 borrowing strategy is to use internal balances to fund new or replacement borrowing up to the value of 25% of the portfolio. This is intended to reduce the cost of carry (the difference between borrowing rates and investment returns) in the low interest rate environment and reduce counterparty risk by minimising the level of cash balances.

14. There has been no change to this strategy.

15. The Council's cumulative total external debt has decreased from £412.38m on 1 April 2013 to £406.38m by 30 September 2013, a net decrease of £6m. No new debt financing has been arranged during the year. The total forecast external debt as at 31 March 2014, after repayment of loans maturing during the year, is £401.38m. The forecast debt financing position for 31 March 2014 is shown in Annex 2.

16. At 30 September 2013, the authority had 67 PWLB[1] loans totalling £356.38m and 10 LOBO[2] loans totalling £50m. The combined weighted average interest rate for external debt as at 30 September 2013 was 4.53%.

Maturing Debt

17. The Council repaid £6m of maturing PWLB loans during the first half of the year. The details are set out in Annex 3.

Debt Restructuring

18. There has been no restructuring of Long Term Debt during the year to date.

Investment Strategy

19. The security and liquidity of cash was prioritised above the requirement to maximise returns. The Council continued to adopt a cautious approach to lending to financial institutions and continuously monitored credit quality information relating to counterparties.

20. A mixture of short term fixed deposits of up to 12 months and longer term fixed deposits of greater than 12 months have been arranged throughout the first half of the financial year. All deposits with banks have been restricted to a maximum duration of twelve months. Deposits over twelve months have been made exclusively with other Local Authorities. The majority of these deposits have been made for the maximum duration of three years to tie in to high credit quality counterparties over the longer term and to maximise the return available in the current low-interest environment.

21. The Council received a fourth distribution from the Landsbanki winding-up board on 12 September 2013. A total of £2.634m has now been received. The Council had £5m on deposit with Landsbanki. The latest CIPFA guidance assumes that the full amount may be recovered by 2018, although the timings and amounts of future distributions remain unknown.

The Council's Lending List

22. The Council's in-house cash balances were deposited with institutions that meet the Council's approved credit rating criteria. The approved Lending List was regularly updated during the period to reflect changes in bank and building society credit ratings. Changes were reported to Cabinet on a bi-monthly basis. Annex 1 shows the amendments

[1] PWLB (Public Works Loans Board) is a Government agency operating within the United Kingdom Debt Management Office and is responsible for lending money to Local Authorities.
[2] LOBO (Lender's Option/Borrower's Option) Loans are long-term loans which include a re-pricing option for the bank at predetermined intervals.

incorporated into the Lending List during the first half of 2013/14, in accordance with the approved credit rating criteria.

23. In the Chancellor's Mansion House speech on 19th June he signalled his intention to sell the government's stake in the Lloyds Banking Group reasonably soon and a 6% stake was indeed sold to institutional investors on 17th September at a price of 75p. In a positive move, Fitch upgraded Lloyds' viability rating to BBB+. The changes have not had any impact on our banking relationship with Lloyds.

24. Breaches in policy have been reported to Cabinet as part of the bi-monthly financial monitoring. There has been no significant financial impact as a result of these breaches.

Investment Performance

25. Security of capital has remained the Authority's main investment objective. This has been maintained by following the Authority's counterparty policy as set out in its Treasury Management Strategy for 2013/14.

26. The average daily balance of temporary surplus cash invested in-house in the six months to 30 September was £371.1m. The Council achieved an average in-house return for that period of 0.87%, marginally below the target rate of 0.90% set in the strategy. This has produced gross interest receivable of £1.610m (excluding interest accrued on Landsbanki deposits). Temporary surplus cash includes; Government grants received in advance, developer contributions, SAP school balances, council reserves and balances, working capital, trust fund balances, and various other funds to which the Council pays interest at each financial year end, based on the average rate earned on all balances.

27. The Council uses the three month inter-bank sterling bid rate as its benchmark to measure its own in-house investment performance. During the first half of 2013/14 the average three month inter-bank sterling rate was 0.38%. The Council's average in-house return of 0.87% exceeded the benchmark by 0.49%. The Council operates a number of call accounts and instant access Money Market Funds to deposit short-term cash surpluses. The average balance held on overnight deposit in money market funds or call accounts in the 6 months to 30 September was £43.9million or 12% of the total in house portfolio.

External Fund Managers and Pooled Funds

28. The Council has continued to use the services of one external fund manager: Investec Asset Management Limited. Proportions of the £12.1m portfolio are invested in three different types of investment fund. The Council has invested in the 'Dynamic Model' where 5% of the portfolio is invested in a Liquidity Fund, 65% is invested in a Short Dated Bond Fund and the remaining 30% is invested in a Target Return Fund. The Target Return fund is the most volatile aspect of the portfolio, carrying greater risk but also the most opportunity for significant returns.
29. Investec's annualised return for the first six months of the year (net of management charges) was 0.00%, compared with a benchmark of 1.59%. Failure to achieve the benchmark has primarily been due to the underperformance of the Target Return and Short-Dated Bond Fund elements of the portfolio. Over the period market conditions have been volatile due to developments in the global economy and the US in particular which has impacted on performance. It should be borne in mind that the Investec portfolio is a long-

term investment and so performance needs to be considered over a longer time period. The three year return for the portfolio is 0.88% against a benchmark of 1.34%. The Treasury Management Strategy Team is continually monitoring the performance of the Investec portfolio and continues to keep all external funds under review.

30. The Council continued to use pooled funds with variable net asset value operated by Scottish Widows Investment Partnership, Federated, and Payden & Rygel. The annualised returns over the period to 30 September 2013 for these funds were 0.53%, 0.59%, and 0.17% respectively. As with the Investec fund these investments are held with a long-term view and performance is assessed accordingly.

Prudential Indicators for Treasury Management

31. The position as at 30 September 2013 for the Prudential Indicators is shown in Annex 4.

External Performance Indicators and Statistics

32. The County Council is a member of the CIPFA Treasury and Debt Management benchmarking club and receives annual reports comparing returns and interest payable against other authorities. The benchmarking results for 2012/13 showed that Oxfordshire County Council had achieved an average return of 0.98% compared with an average of 0.97% for their comparative group of County Councils and an average of 1.10% for all 68 members.

33. The average interest rate paid for all debt during 2012/13 was 4.52%, lower than the 4.75% average for the comparative group of 19 County Councils and the same as the all member average of 4.52%. It should be noted that all of Oxfordshire County Council’s debt is long-term whereas the averages for the comparators include short-term debt which has a lower interest rate and so reduces the averages. Oxfordshire County Council had a higher than average proportion of its debt portfolio in PWLB loans at 88% compared to 76% for the all member group and 81% for the comparative group. Oxfordshire County Council had 12% of its debt in LOBO loans at 31 March 2013 compared with an average of 18% for both the all member group and comparative group.

34. Arlingclose also benchmark the Council’s investment performance against its other clients on a quarterly basis. The results of the quarter 2 benchmarking to 30 September 2013 for 2013/14 are included at Annex 5.

35. The benchmarking results show that the Council has achieved higher than average interest on deposits at 30 September 2013. This has been achieved by placing deposits over a longer than average duration with institutions that are of better than average credit quality. This reflects the current investment strategy to place long term deposits with other local authorities to maximise the security of cash.

Training

36. Individuals within the Treasury Management Team continued to keep up to date with the latest developments and have attended a number of external workshops. Some members of the team also visited one of our brokers to shadow them for a morning in order to gain insight in to how brokers operate.

Financial and Legal Implications

37. Interest payable and receivable in relation to Treasury Management activities are only two parts of the overall Strategic Measures budget.

38. The 2013/14 budget for interest receivable is £2.115m. The forecast outturn for interest receivable is £2.859m giving net forecast excess income of £0.744m. The increased forecast in interest receivable is due to higher average cash balances due in part to the front loading of government grants and the timings of capital and revenue expenditure.

39. The 2013/14 budget for interest payable is £18.405m. The forecast outturn for interest payable is £18.536m giving a net forecast overspend of £0.131m.

RECOMMENDATION

40. **The Cabinet is RECOMMENDED to note the report, and to RECOMMEND Council to note the Council's Mid-Term Treasury Management Review 2013/14.**

LORNA BAXTER
Chief Finance Officer

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November 2013

Annex 1

Lending List Changes during 2013/14

Counterparties added/reinstated

Close Brothers
Credit Suisse

Counterparties removed

No Counterparties have been removed from the Lending List between 1 April 2013 and 30 September 2013.

Lending limits & Maturity limits increased

Counterparty	New Lending limit	New Maximum Maturity
Standard Chartered Bank	no change	12 months
Svenska Handelsbanken	no change	12 months
JP Morgan Chase Bank	no change	9 months
HSBC Bank Plc	£25m	no change
UK Local Authorities	£30m	no change
Morgan Stanley MMF	£5m	no change
Federated MMF	£12m	no change

Lending limits & Maturity limits decreased

Counterparty	New Lending limit	New Maximum Maturity
Royal Bank of Scotland	no change	Overnight (was increased to 6 months earlier in period)
Nationwide Building Society	no change	6 months (was increased to 9 months earlier in period)

Annex 2

OXFORDSHIRE COUNTY COUNCIL DEBT FINANCING 2013/14

Debt Profile		£m
1. PWLB	90%	362.37
2. Money Market LOBO loans	12%	50.00
3. Sub-total External Debt		412.37
4. Internal Balances	-2%	-9.04
5. Actual Debt at 31 March 2013	**100%**	**403.33**
6. Government Supported Borrowing		0.00
7. Unsupported Borrowing		12.33
8. Borrowing in Advance		0.00
9. Minimum Revenue Provision		-16.82
10. Forecast Debt at 31 March 2014		**398.84**
Maturing Debt		
11. PWLB loans maturing during the year		-11.00
12. PWLB loans repaid prematurely in the course of debt restructuring		0.00
13. Total Maturing Debt		**-11.00**
New External Borrowing		
14. PWLB Normal		0.00
15. PWLB loans raised in the course of debt restructuring		0.00
16. Money Market LOBO loans		0.00
17. Total New External Borrowing		**0.00**
Debt Profile Year End		
18. PWLB	88%	351.37
19. Money Market LOBO loans	13%	50.00
20. Sub-total External Debt		401.37
21. Internal Balances	-1%	-2.53
22. Forecast Debt at 31 March 2014	**100%**	**398.84**

Line

1 – 5 This is a breakdown of the Council's debt at the beginning of the financial year (1 April 2013). The PWLB is a government agency operating within the Debt Management Office. LOBO (Lender's Option/ Borrower's Option) loans are long-term loans, with a maturity of up to 60 years, which includes a re-pricing option for the bank at predetermined time intervals. Internal balances include provisions, reserves, revenue balances, capital receipts unapplied, and excess of creditors over debtors.

6 'Government Supported Borrowing' is the amount that the Council can borrow in any one year to finance the capital programme. This is determined by Central Government, and in theory supported through the Revenue Support Grant (RSG) system.

7 'Unsupported Borrowing' reflects Prudential Borrowing taken by the authority whereby the associated borrowing costs are met by savings in the revenue budget.

8 'Borrowing in Advance' is the amount the Council borrowed in advance to fund future capital finance costs.

9 The amount of debt to be repaid from revenue. The sum to be repaid annually is laid down in the Local Government and Housing Act 1989, which stipulates that the repayments must equate to at least 4% of the debt outstanding at 1 April each year.

10 The Council's forecast total debt by the end of the financial year, after taking into account new borrowing, debt repayment and movement in funding by internal balances.

11 The Council's normal maturing PWLB debt.

12 PWLB debt repaid early during the year.

13 Total debt repayable during the year.

14 The normal PWLB borrowing undertaken by the Council during 2013/14.

15 New PWLB loans to replace debt repaid early.

16 The Money Market borrowing undertaken by the Council during 2013/14.

17 The total external borrowing undertaken.

18-22 The Council's forecast debt profile at the end of the year.

Annex 3

<u>Long-Term Debt Maturing 2013/14</u>

Public Works Loan Board: Loans Matured during first half of 2013/14

Date	Amount £m	Rate %
22/05/2013	5.000	4.20%
13/07/2013	0.500	2.35%
31/07/2013	0.500	2.35%
Total	**6.000**	

Public Works Loan Board: Loans Due to Mature during second half of 2013/14

Date	Amount £m	Rate %
31/12/2013	4.000	4.90%
13/01/2013	0.500	2.35%
31/01/2013	0.500	2.35%
Total	**5.000**	

Annex 4

Prudential Indicators Monitoring at 30 September 2013

Authorised and Operational Limit for External Debt

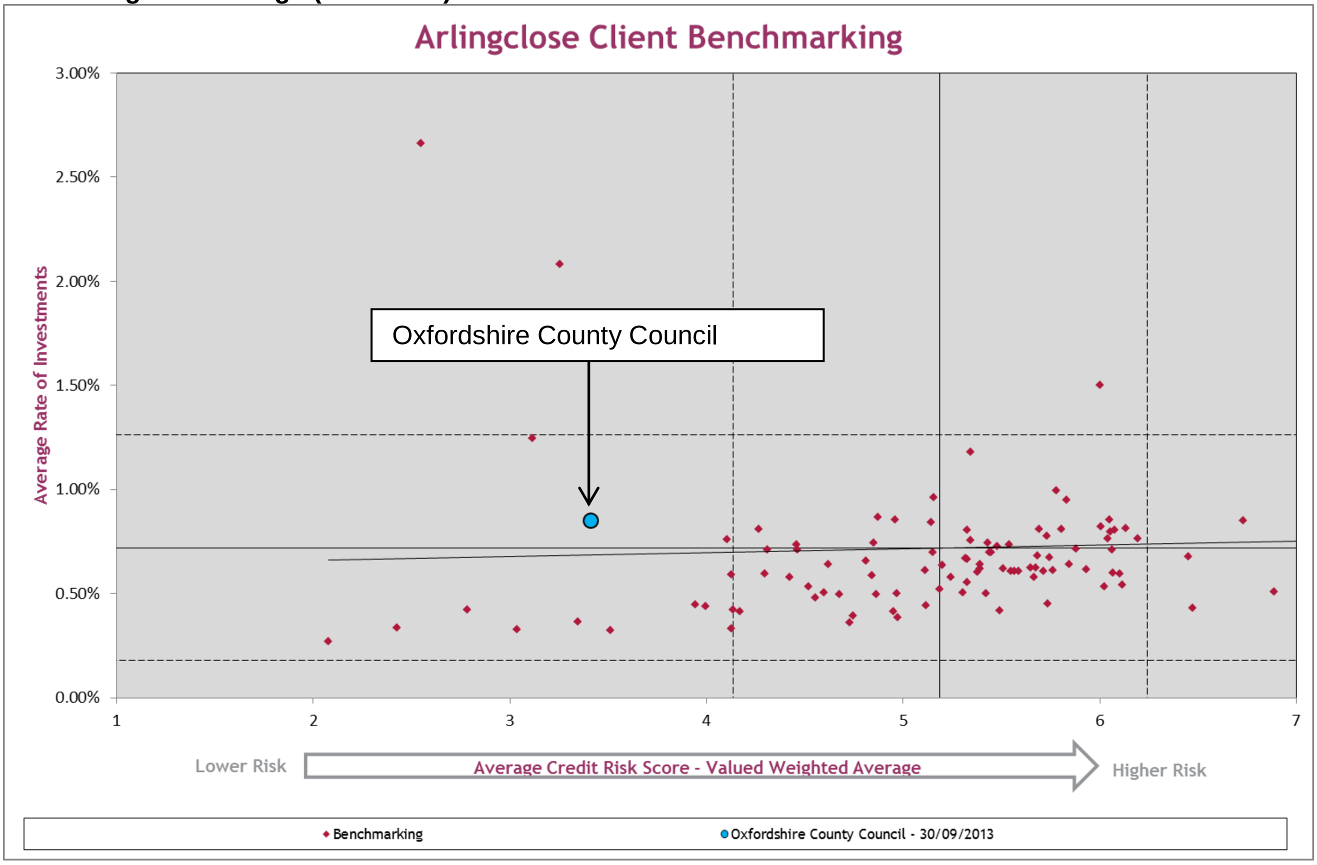
External Debt	Operational Limit £m	Authorised Limit £m	Actual 30/09/13 £m	Forecast 31/03/14 £m
Borrowing	475	485	406	401
Other Long-Term Liabilities	6	6	6	6
TOTAL External Debt	481	491	412	407

Capital Financing Requirement for year		£428,177,000.00
Fixed Interest Rate Exposure		
Fixed Interest Net Borrowing limit		150.00%
Actual at 30 September 2013	151.57%	
Variable Interest Rate Exposure		
Variable Interest Net Borrowing limit		25.00%
Actual at 30 September 2013	-51.57%	
Sums Invested over 365 days		
Total sums invested for more than 364 days limit	£100,000,000	
Actual sums invested for more than 364 days		£ 98,365,590

Maturity Structure of Borrowing

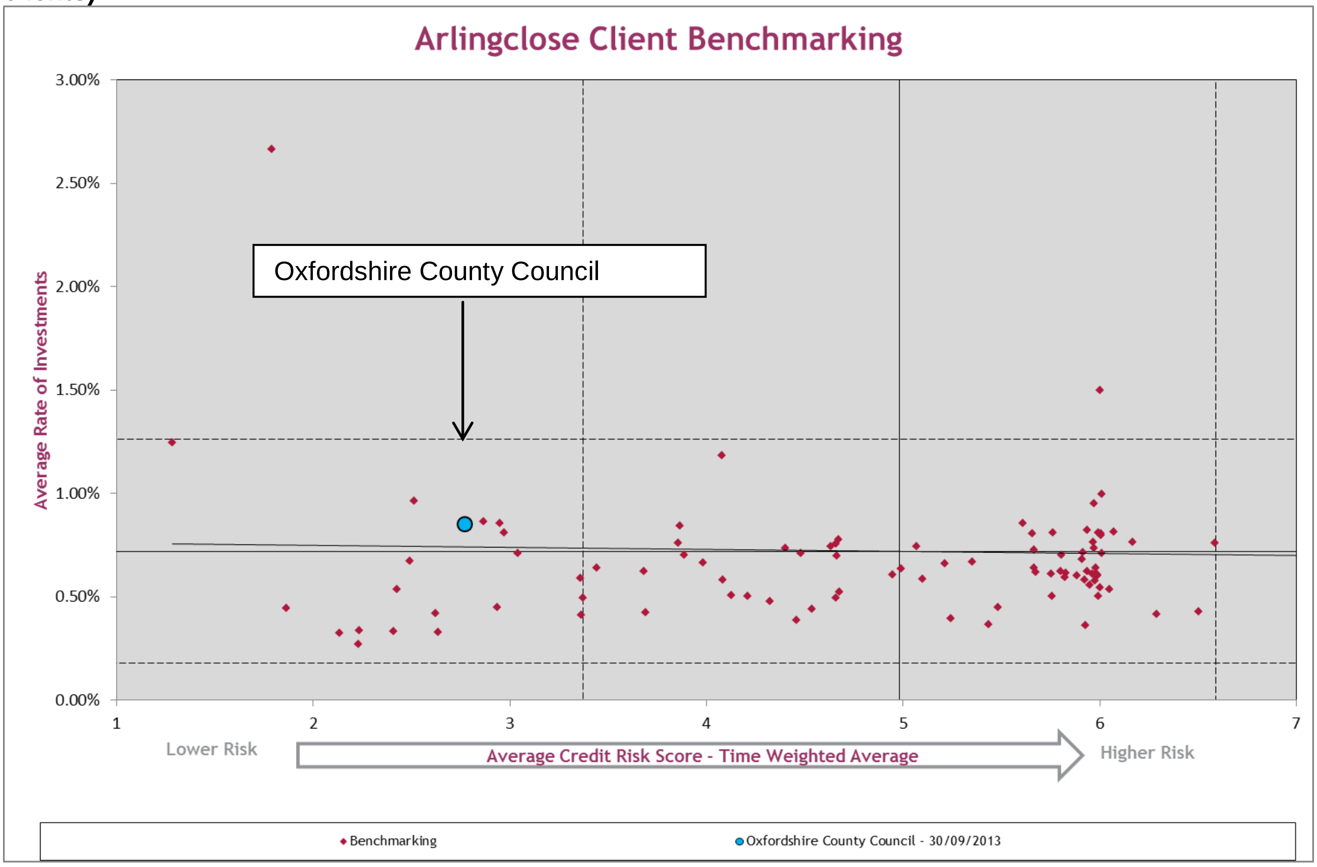
	Limit %	Actual %
Under 12 months	0 - 20	6.40
12 – 24 months	0 - 25	2.71
24 months – 5 years	0 - 35	16.73
5 years to 10 years	5 - 40	12.06
10 years +	50 - 95	62.10

Value weighted average (all clients)



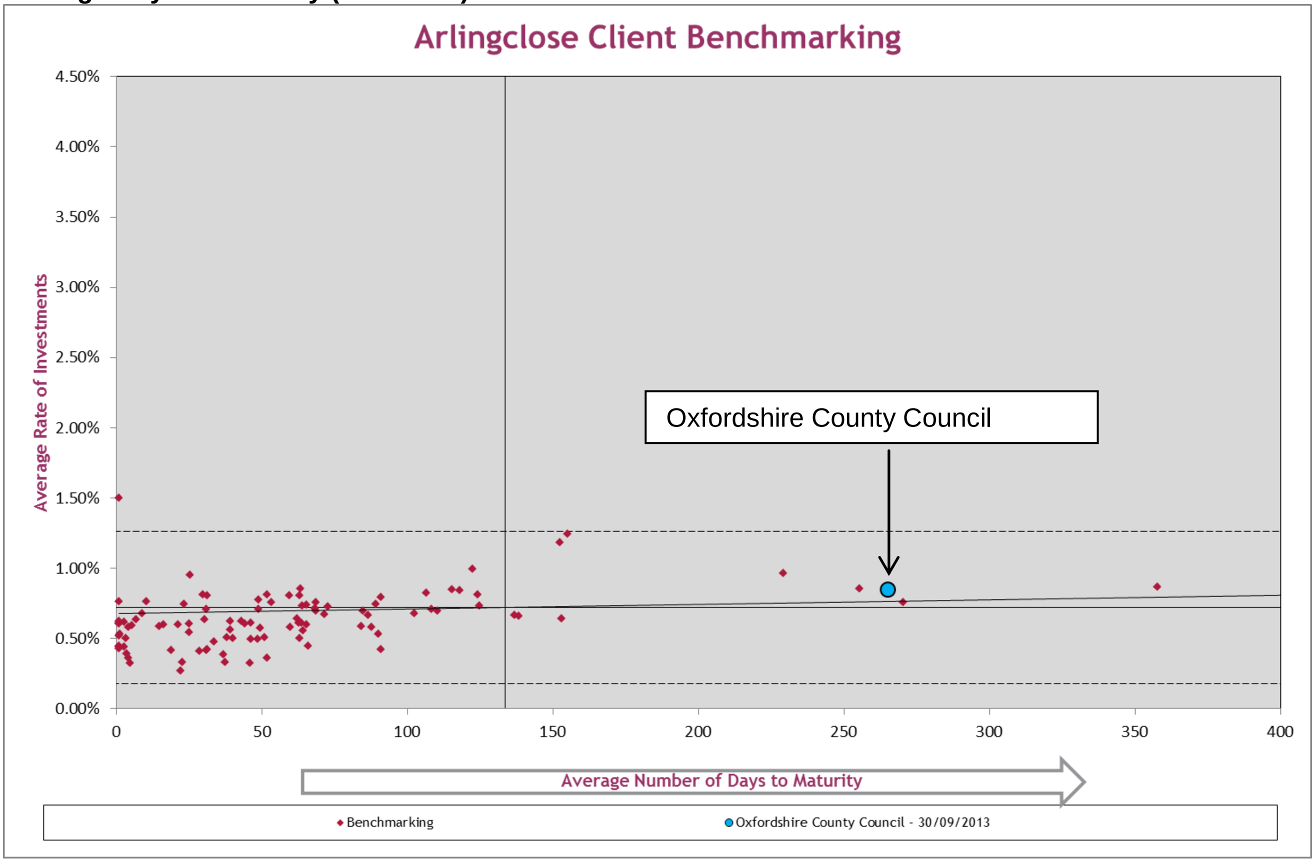
This graph shows that, at 30 September 2013, Oxfordshire achieved a higher than average return for lower than average credit risk, weighted by deposit size.

Time weighted Average (all clients)



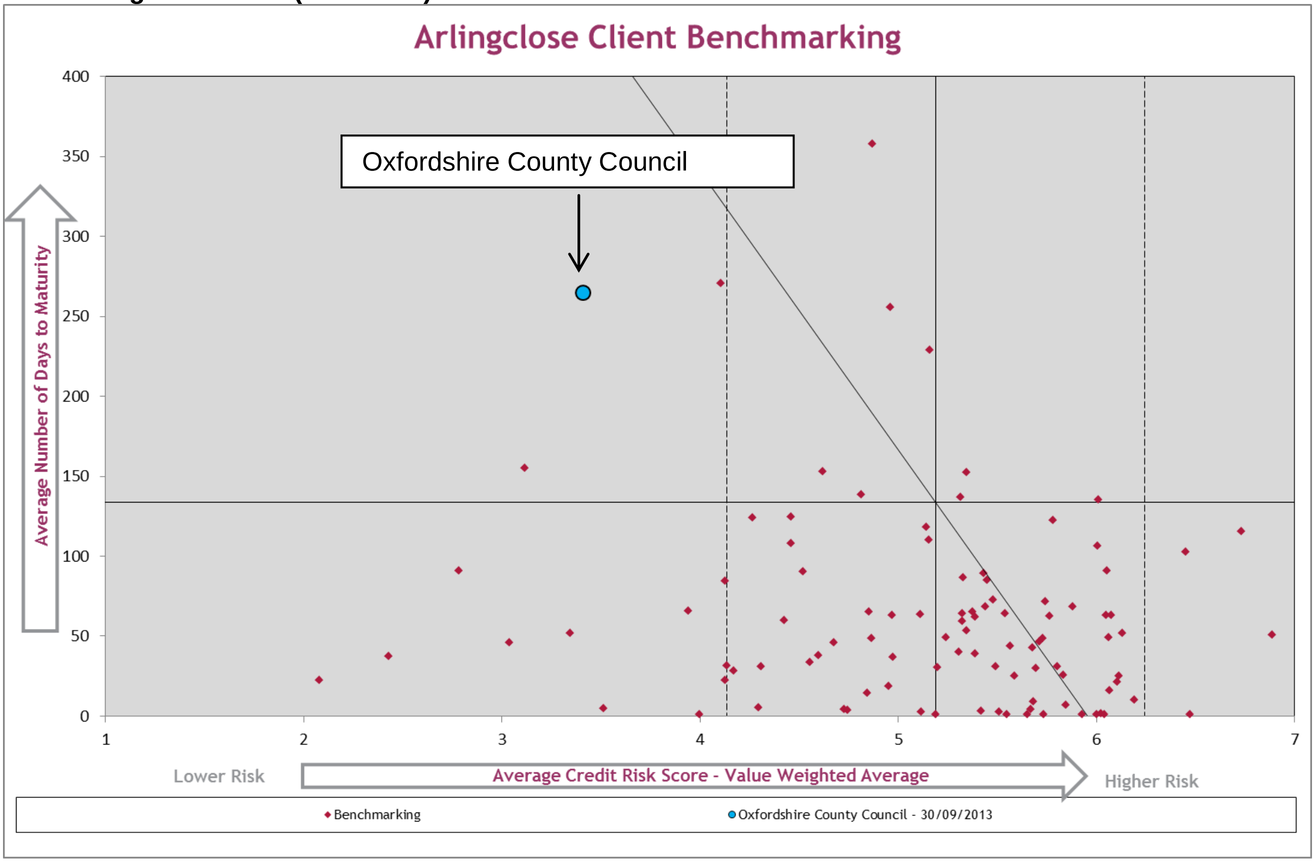
This graph shows that, at 30 September 2013, Oxfordshire achieved higher than average return for lower than average credit risk, weighted by duration.

Average Days to Maturity (all clients)



This graph shows that, at 30 September 2013, Oxfordshire achieved a higher than average return by placing deposits for longer than average duration.

Value Weighted Credit (all clients)



This graph shows that, at 30 September 2013, Oxfordshire had a higher than average duration for deposits and that these deposits are made with institutions with lower than average credit risk when weighted by deposit size.