1. Background

1.1 The Treasury Management Strategy for 2013/14 has been developed by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009 (revised 2011), which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority has adopted the code and complies with its requirements, one of which is the provision of a Mid-year report to Members.

2. Economic update for the first six months

2.1 The following key points have been provided by the councils Treasury Advisors, Capita Asset Services.

2.2 During 2013/14 economic indicators suggested that the economy is recovering, albeit from a low level. After avoiding recession in the first quarter of 2013, with a 0.3% quarterly expansion the economy grew 0.7% in Q2. There have been signs of renewed vigour in household spending in the summer, with a further pick-up in retail sales, mortgages, house prices and new car registrations.

2.3 The strengthening in economic growth appears to have supported the labour market, with employment rising at a modest pace and strong enough to reduce the level of unemployment further. Pay growth also rebounded strongly in April, though this was mostly driven by high earners delaying bonuses until after April's cut in the top rate of income tax. Excluding bonuses, earnings rose by just 1.0% y/y, well below the rate of inflation at 2.7% in August, causing continuing pressure on household's disposable income.

2.4 The Bank of England extended its Funding for Lending Scheme (FLS) into 2015 and sharpened the incentives for banks to extend more business funding, particularly to small and medium size enterprises. To date, the mortgage market still appears to have been the biggest beneficiary from the scheme, with mortgage interest rates falling further to new lows. Together with the Government's Help to Buy scheme, which provides equity loans to credit-constrained borrowers, this is helping to boost demand in the housing market. Mortgage approvals by high street banks have risen as have house prices, although they are still well down from the boom years pre 2008.

2.5 Turning to the fiscal situation, the public borrowing figures continued to be distorted by a number of one-off factors. On an underlying basis, borrowing in Q2 started to come down, but only slowly, as Government expenditure cuts took effect and economic growth started to show through in a small increase in tax receipts. The 2013 Spending Review, covering only 2015/16, made no changes to the headline Government spending plan, and monetary policy was unchanged in advance of the new Bank of England Governor, Mark Carney, arriving. Bank Rate remained at 0.5% and quantitative easing also stayed at £375bn. In August, the MPC provided forward guidance that Bank Rate is unlikely to change until unemployment first falls to 7%, which was not expected until mid-2016. However, 7% is only a point at which the MPC will review Bank Rate, not necessarily take action to change it. The three month to July average rate was 7.7%. CPI inflation (MPC target of 2.0%), fell marginally from a peak of 2.9% in June to 2.7% in August. The Bank of England expects inflation to fall back to 2.0% in 2015.

3. Investments

The DCLG's Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy for 2013/14 approved by Council on the 8th February 2013. This restricted any new investments to the following:-

- Term Deposits/CD's with banks and building societies
- Other Local Authorities
- T-Bills and the Debt Management Office (DMO)
- Gilts
- Bonds issued by Multilateral Development Banks
- Commercial Paper/Corporate Bonds
- AAA rated Money Market Funds
- Other Money Market and Collective Investment Schemes

Counterparty credit quality is assessed and monitored with reference to:-

- Credit ratings
- Credit Default Swaps
- Share Price
- GDP of the country in which the institution operates

3.1 It is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.50% Bank Rate. Indeed, the introduction of the Funding for Lending scheme has reduced market investment rates even further. The potential for a prolonging of the Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. As agreed as part of the 2013/14 Treasury Management Strategy investments were only to be made to UK based banks/building society which met the lending criteria set, and up to a maximum period of one year. Treasury officers have kept to this strategy for the period reported on. Given this risk environment, investment returns are likely to remain low.

3.2 Investments - Movements in the Council's investment portfolio during the first six months of 2013/14 can be seen in the table below.

Source of Loan **Short term Lending**	**Balance at 1 April 2013 £**	**Raised during Apr-Sept £**	**Repaid during Apr-Sept £**	**Balance at 30 Sept 2013 £**
Bank – Term Deposits	7,500.000	6,000,000	4,000,000	9,500,000
Building Societies	0	2,000,000	0	2,000,000
Call Accounts	5,100,000	40,675,000	38,330,000	7,445,000
Money Market Funds	0	10,780,000	10,780,000	0
Pooled Funds	2,000,000	0	0	2,000,000
Total Short Term Lending	**14,600,000**	**59,455,000**	**53,110,000**	**20,945,000**
Icelandic Banks in administration	**Balance at 1 April 2013 £**	**Raised during Apr-Sept £**	**Repaid during the year £**	**Balance at 30 Sept 2013 £**
Glitnir	400,000	0	0	400,000
Total Icelandic Banks	**400,000**	**0**	**0**	**400,000**
Total External Investments	**15,000,000**	**59,455,000**	**53,110,000**	**21,345,000**

4.3 In February 2013 the Council's Investment income for 2013/14 was budgeted to be £170,750. The average cash balances representing the council's reserves and working balances, was £18.4m during the period this report covers. The Council anticipates an investment outturn of £183,400 at a rate of 0.89% for the whole year. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2013/14.

4.4 Included within the investments of £21.345m as of 30th September 2013, the Council has £0.4m deposited in the collapsed Icelandic bank, Glitnir. Glitnir's Winding – up - Board made a distribution to priority creditors back in March 2012, which amounted to 78p in the pound. The remaining balance is held in an escrow account in Iceland. The Central Bank of Iceland is controlling the movement of Icelandic Krona's, so the Council has been unable to gain access to these funds. The

Council is working with the Local Government Association (LGA) and Bevan Brittan (appointed solicitors) to recover the remaining amount. 100% is expected to be recovered.

5. Prudential Indicators

5.1 During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Annual Treasury Strategy Statement. Appendix 1 attached highlights the major indicators.

6. Outlook

6.1 Economic forecasting remains difficult with so many external influences weighing on the UK. Volatility in bond yields is likely during 2013/14 as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities and safer bonds. The overall balance of risks to economic recovery in the UK is now weighted to the upside after five months of robust good news on the economy. However, only time will tell just how long this period of strong economic growth will last, and it remains exposed to vulnerabilities in a number of key areas.

6.2 Expectations for the first change in Bank Rate in the UK are now dependent on how to forecast when unemployment is likely to fall to 7%. Financial markets have taken a very contrary view to the MPC and have aggressively raised short term interest rates and gilt yields due to their view that the strength of economic recovery is now so rapid that unemployment will fall much faster than the Bank of England forecasts. They therefore expect the first increase in Bank Rate to be in quarter 4 of 2014. There is much leeway to disagree with this view as the economic downturn since 2008 was remarkable for the way in which unemployment did not rise to anywhere near the extent likely, unlike in previous recessions. This meant that labour was retained, productivity fell and now, as the MPC expects, there is major potential for unemployment to fall only slowly as existing labour levels are worked more intensively and productivity rises back up again. The size of the work force is also expected to increase relatively rapidly and there are many currently self-employed or part time employed workers who are seeking full time employment. Capita Asset Services take the view that the unemployment rate is not likely to come down as quickly as the financial markets are currently expecting and that the MPC view is more realistic. The prospects for any increase in Bank Rate before 2016 are therefore seen as being limited. However, some forecasters are forecasting that even the Bank of England forecast is too optimistic as to when the 7% level will be reached and so do not expect the first increase in Bank Rate until spring 2017.

	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%
5yr PWLB rate	2.50%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%
10yr PWLB rate	3.70%	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%	4.60%	4.60%
25yr PWLB rate	4.40%	4.40%	4.40%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.10%	5.10%	5.20%
50yr PWLB rate	4.50%	4.40%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.20%	5.20%	5.30%

7. Performance management

7.1 In compliance with the requirements of the Treasury Management CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first six months of 2013/14. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

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Appendices	Prudential Indicators Appendix 1
Background information	Treasury Management Strategy, Council 26th February 2013

The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

This table shows the revised estimate for capital expenditure and change since the capital programme was agreed as part of the budget setting process.

Capital Expenditure by Service	2013/14 Original Estimate £m	2013/14 Current Budget* £m	Position as at 30th Sept 2013 £m
General Fund	4.395	7.259	0.910
Total	**4.395**	**7.259**	**0.910**

*** Current budget includes those capital schemes approved since the Prudential Indicator was set in February 2013.**

Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. Any borrowing element in the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

The Council currently has no requirement to borrow.

Capital Expenditure	2013/14 Original Estimate £m	2013/14 Current Budget* £m	Position as at 30th Sept 2013 £m
Financed by:			
Capital receipts	3.235	5.924	0.555
Capital grants	0.410	0.585	0.355
Earmarked reserves (revenue)	0.500	0.500	0
Revenue	0.250	0.250	0
Total financing	**4.395**	**7.259**	**0.910**
Borrowing need	0	0	0

Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

We are on target to achieve the original forecast Capital Financing Requirement

Prudential Indicator – External Debt / the Operational Boundary

The operational boundary represents the maximum operational borrowing limit at any one time.

	2013/14 Original Estimate £m	Actual position as at 30th Sept 2013 £m
Prudential Indicator – Capital Financing Requirement		
Total CFR	0	0
Net movement in CFR	**0**	**0**
Prudential Indicator – The Operational Boundary		
Borrowing	4.500	0
Other long term liabilities	0	0
Total debt 31 March	**4.500**	**0**

Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2013/14 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2013/14 Original Estimate £m	Position as at 30th Sept 2013 £m
Gross borrowing	0	0
CFR (year-end position)	0	0

The Chief Finance Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2013/14 Original Indicator £m	Actual debt as at 30th Sept 2013 £m
Borrowing	6.500	0
Other long term liabilities	0	0
Total	**6.500**	**0**