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PR.25 14/15	
Policy and Resources Committee	
6th November 2014	

Subject: Budget and Treasury Management Monitoring – Quarter 2 2014/15 and Mid Year Treasury Report

Report by:	Group Accountant Tracey Bircumshaw
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Purpose / Summary:	This report sets out the revenue, capital and treasury management activity during the period 2 April to 30 September 2014.

RECOMMENDATION(S):

That Members note the forecast out-turn position as at 30 September 2014

Members approve the revised Capital Budget of £2.684m and to approve carry forward requests of £2.050m to 2015/2016 and note the property acquisitions to be added to the Asset Register.

That Members note the Treasury Management Mid Year Report and Treasury position for the six months to 30 September 2014.

- **Note the report, the treasury activity changes to the prudential indicators.**
- **Recommend approval of the changes to the credit methodology whereby viability, financial strength and support ratings will not be considered as key criteria in the choice of creditworthy investment counterparties.**

IMPLICATIONS

Legal: None arising as a result of this report.

Financial FIN/76/15

The revenue forecast out-turn position for 2014/15 is estimated to be a surplus of £553,054 at 30 September 2014 (£358,510 at 30 June), work will continue throughout the year to monitor the situation and to identify ongoing impacts on the Medium Term Financial Plan as part of the Budget Process.

The Capital forecast out-turn position for 2014/15 is estimated to be a £2,684,461 and requests to carry forward £2,050,684 will require approval as schemes are reprofiled over the medium term to inform the Capital and Treasury Management Strategy 2015/16.

The treasury management activities during the reporting period are disclosed in the body of this report.

There were no breaches of Treasury and Prudential Indicators to report, and we again out-perform our benchmark in relation to investment yields.

Staffing : None arising as a result of this report.

Equality and Diversity including Human Rights : None arising as a result of this report.

Risk Assessment : This is a monitoring report only.

Climate Related Risks and Opportunities : This is a monitoring report only.

Title and Location of any Background Papers used in the preparation of this report:

Call in and Urgency: Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)	**Yes**		**No**	x

Key Decision:

A matter which affects two or more wards, or has significant financial implications	**Yes**		**No**	x

1. REVENUE BUDGET MONITORING Q2 (APRIL – SEPTEMBER 2014/15)

1.1 The revenue budget monitoring forecast out-turn as at the end of Quarter 2 reflects a surplus of £553,054

Revenue Budget Monitoring Q1 April - September 2014

		2014/15 Original Budget £	2014/15 Revised Budget £	2014/15 Actual To 30 Sept £	2014/15 Variance to Budget £	2014/15 Forecast Outturn £	2014/15 Outturn Variance £
INCOME							
	Housing Benefit Govt Grants	-22,473,700	-22,473,700	-10,986,627	-254,713	-22,509,000	-35,300
	Service Specific Govt Grant	-836,400	-1,029,000	-1,039,813	660,187	-1,129,400	-100,400
	Other Grants and contribns	-447,500	-447,500	-177,665	-43,177	-476,460	-28,960
	Customer and Client Receipts	-1,945,600	-2,372,000	-1,911,172	959,665	-2,839,550	-467,550
	Interest and Investment Income	-200,000	-200,000	-36,947	-63,093	-206,560	-6,560
	Revenue Support Grant	-3,065,700	-3,065,700	-1,609,495	0	-3,096,700	-31,000
	Non Specific Grants	0	-130,600	-93,612	93,612	-158,000	-27,400
	Retained NNDR	-2,132,300	-2,132,300	-1,468,263	0	-2,132,300	0
	New Homes Bonus	-1,548,800	-1,548,800	-783,762	0	-1,557,850	-9,050
	Council Tax	-5,295,100	-5,295,100	-2,647,550	2,647,550	-5,295,100	0
	Share of Council Tax Surplus	-125,800	-125,800	0	0	-125,800	0
Total Income		**-38,070,900**	**-38,820,500**	**-20,754,906**	**4,000,031**	**-39,526,720**	**-706,220**
EXPENDITURE							
	Employees	8,653,700	9,042,700	4,323,215	119,720	9,098,420	55,720
	Premises	999,900	1,016,930	792,159	-218,793	1,044,630	27,700
	Transport	1,174,500	1,193,900	684,908	-124,844	1,184,700	-9,200
	Supplies and Services	2,054,600	2,266,845	1,337,062	-202,851	2,289,490	22,645
	Third Party Payments	1,094,200	1,707,580	1,199,207	-771,568	1,758,980	51,400
	Transfer Payments	22,955,900	22,963,900	11,570,982	8,814	22,959,500	-4,400
Total Expenditure		**36,932,800**	**38,191,855**	**19,907,533**	**-1,189,522**	**38,335,720**	**143,865**
SERVICES Controllable		**-1,138,100**	**-628,645**	**-847,373**	**2,810,509**	**-1,191,000**	**-562,355**
CORPORATE ACCOUNTING							
	Parish Precepts	1,466,300	1,466,300	1,457,003	9,297	1,466,300	0
	Parish Council Tax Requirement	-1,466,300	-1,466,300	0	0	-1,466,300	0
	Drainage Board Levies	310,000	310,000	164,302	-9,302	319,301	9,301
STATUTORY ACCOUNTING							
	Capital Charges	1,086,200	1,086,200	0	0	1,086,200	0
	Capital Accounting Adjustment	-1,086,200	-1,086,200	0	0	-1,086,200	0
	Capital Exp Charge to Gen Fund	2,071,200	1,972,200	0	0	1,972,200	0
	Support Services	5,204,400	5,413,400	0	0	5,413,400	0
	Recharges	-5,210,400	-5,210,400	0	0	-5,210,400	0
		1,237,100	**1,856,555**	**773,931**	**2,810,505**	**1,303,501**	**-553,054**
MOVEMENT IN RESERVES							
	Transfer to from Spec Reserves	-2,071,200	-2,264,175	0	0	-2,264,175	0
	Transfer to from General Fund	834,100	407,620	0	0	407,620	0
SURPLUS FOR THE YEAR		**0**	**0**	**773,931**	**2,810,505**	**-553,054**	**-553,054**

1.2 The major variances of note are detailed below;

INCOME

Grant income - £201,110 surplus

Additional Government grants have been received for;

Rural Efficiency Grant £43,000
Community Right to Challenge -New Burdens £8,000
Assets of Community Value - New Burdens £8,000
New Homes Bonus returned funding grant of £9,050
Council Tax Localisation - New Burdens £76,000

It has yet to be announced whether all of these grants will be received in future years, we therefore await confirmation prior to inclusion in the Medium Term Financial Plan 2015/16-2019/20

Housing Benefits Admin Grant offset by increased costs of grants awarded £35,300

Service Specific Grants which will be expended during the year £53,000

Customer and Client Receipts - £467,550 surplus

Planning Fee income to date totals £549,000 against the annual budget of £460,500, therefore it is estimated that an additional £400,000 above budget, will be received before the year end based on current levels of applications. However there is a need for additional temporary resources to meet the current demand. This is a highly volatile area and will be monitored closely for the remainder of the year.

Trinity Arts Centre performance have scheduled more events and anticipate an additional income in box office and theatre takings of £27,000, this is offset by the costs of the events totalling £10,000.

£38,000 contribution from the Police Authority towards the cost of a secondee.

Investment Income - £6,560 surplus

Interest due on the recent Loan advance to support High Speed Rural Broadband.

<u>EXPENDITURE</u>

Employees - £55,720 deficit

Net employee costs, ie vacancy savings, pay award not yet determined, and requirement for temporary staffing resources eg additional workloads in the Planning Service.

Premises - £9,200 surplus

Various small amounts

Supplies and Services £22,645 deficit

Additional performance costs at Trinity Arts Centre £10,000

Third Party Payments - £51,400 deficit

£44,000 for support with strategic asset management and the Land and Property investment programme projects and the support for the decommissioning of MoD sites.

The estimated costs associated with a planning appeal £80,000 previously reported, have now been met from approved carry forward surpluses from 2013/14 and therefore is no longer a budget pressure.

Transfer Payments - £4,400 surplus

Housing benefit payments the surplus of £35,000 which will be offset by a reduction in Housing benefit subsidy grant.

Corporate Accounting - £9,301 deficit

Levies raised exceed estimated budget provision

2. CHANGES TO THE ORGANISATION STRUCTURE

2.1 Changes to the establishment are made under Corporate Delegation by the Chief Executive and S151 Officer;

The following changes to the establishment have been made,

Development and Neighbourhoods
New Posts – Principal Planning Officer x 2
New Post – Validation Officer
Deleted Post – Area Development Officer
New Post – Events Co-Ordinator Officer (Fixed Term Contract 2 years)

Total Costs of £91,000

The costs of these posts will be met from additional income within the service, and will be incorporated into the Medium Term Financial Plan 2015/16

3. CAPITAL BUDGET MONITORING Q2 (APRIL-SEPTEMBER 2014/15)

3.1 The Capital Programme 2014/15 was approved at Council on 3rd March 2014 and totalled £4.566m.

3.2 The revised Capital budget of £4.735m incorporates both carry forwards approved from 2013/14 and amendments to the Capital Programme previously approved by this Committee.

3.3 The Forecast Out-turn position of £2,684,461 reflects the amounts expected to be expended during the year, and therefore requests to carry forward £2,050,684 require approval by this committee to re-profile these schemes over the Medium Term Financial Plan. Explanations are provided in the table below;

3.4 Whilst financing of the Capital programme remains the responsibility of the S151 Officer, the release of £104,704 of S106 balances will now be utilised to finance the Strategic Housing Scheme, in accordance with the terms and conditions of the agreements.

3.5 **Acquisitions** during the period have included;

Asset	Market Value £	Purchase Price £	Cost of Works Estimate £	Future Value £	Future Net Yield %
Lea Road School, Gainsborough	41,000	41,000	n/a	n/a	n/a
16 Waterworks Street, Gainsborough	30,000	24,500		40,000	14
18 Waterworks Street, Gainsborough	27,500	27,500		45,000	13

3.6 **Disposals** of land at the east side of The Avenue, Gainsborough £10,000, negotiated as part of the Lea Road School acquisition from Lincolnshire County Council.

3.7 Capital Receipts of £209,006 were received in May relating to our agreement with ACIS for shares of future Right To Buy Receipts subsequent to the transfer of our housing stock.

3.8 There are no schemes requiring funding release;

CAPITAL INVESTMENT PROGRAMME 2014/15

SCHEME	Original Budget 2014/15	Revised Budget 2014/15	Actual to 30 Sept 2014 2014/15	Commit-ments to 30 Sept 2014 2014/15	Budget to Period 2014/15	Variance To Perid 2014/15	Forecast Outturn 2014/15	Outturn Variance 2014/15	Reason
	£	£	£	£	£	£	£	£	
CURRENT PROGRAMME									
Replacement Refuse Freighters	53,270	78,270	18,500	0	25,000	-6,500	78,270	0	Second hand JCB purchased, and a replacement freighter will be procured later in the year.
Strategic Housing - Empty Homes	595,370	627,613	128,260	39,587	313,926	-146,079	370,000	257,613	Remaining properties to be refurbished. Project being rescoped via Commercial Board and reprofiled over MTFP 2015/16
Private Sector Renewal - DFG's	410,454	410,454	172,649	128,910	205,306	96,253	410,454	0	42% of the budget has been expended thus far and a further 31% committed. Due to the level of demand, the DFG's budget will be fully expended.
Independent Living	0	75,000	21,294	7,823	37,512	-8,395	75,000	0	This grant scheme to support independent living will be fully expended in the year.
Property Assets - investment strategy developed	1,500,000	1,575,290	40,001	0	787,960	-747,959	1,040,000	535,290	The Corringham Road project is planned to commence in 2014/15 with completion of the works running into 2015/2016. The projected cost is circa £1,630,000. No other projects are currently planned to commence in 2014/15.
Rural Broadband	555,000	555,000	0	0	0	0	0	555,000	This scheme is being led by Lincolnshire County Council, our contribution is likely to be requested during 2015/16
Caistor Townscape Heritage Scheme		25,000	0	0	0	0	0	25,000	The scheme is essentially closed, we are waiting for one building to rectify some works before we can get HLF's sign off of the project and attract an additional £65k of funding. Officers and Members are doing what we can to speed up the works which due to financial trouble have stalled massively.
Financial Ledger Suite	42,156	52,777	17,346	0	26,398	-9,052	52,777	0	Implementation of HR/Payroll system phase 1 completed. Further system development projects being appraised
Trade Waste	170,000	46,000	7,417	0	20,000	-12,583	46,000	0	Further bins/software purchases required
Capital Enhancements to Council Owned Assets incl Energy Efficiency Measures	480,000	504,846	114,255	3,800	252,526	-134,471	175,000	329,846	Condition survey works - request to carry forward into 2015/16 as data may not be available in time to procure and deliver necessary works within financial year. Trinity Arts Roof - majority of monies to be carried forward into 2015/16 as it is recommended that works are untaken in fair weather.
Business Relocation Fund	50,000	50,000	0	0	0	0	25,000	25,000	Scheme to be launched October, therefore will have a clearer idea of interest by December 2014
Gainsborough Master Plan - Commercial Development Grant Scheme	150,150	172,935	0	0	0	0	25,000	147,935	Scheme to be launched October therefore clearer idea of interest by December 2014
Desktop Refresh/SAN and SQL replacement	60,000	61,960	13,457	0	30,994	-17,537	61,960	0	Replacement programme scheduled throughout the year as licences etc require renewal.
Rural Broadband (Quickline)	500,000	500,000	175,000	0	250,100	-75,100	325,000	175,000	It is anticipated the tranche 3 grant release will take place in 2015/16
Total Investment	**4,566,400**	**4,735,145**	**708,180**	**180,119**	**1,949,722**	**-1,061,423**	**2,684,461**	**2,050,684**	

TREASURY MANAGEMENT MID YEAR REPORT AND Q2 MONTORING

1 Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2 Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2011) was adopted by this Council on 3 March 2011.

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the full Council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a **Mid-year Review Report** and an Annual Report (stewardship report) covering activities during the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Governance and Audit Committee:

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2014/15 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2014/15;
- A review of the Council's borrowing strategy for 2014/15;
- A review of any debt rescheduling undertaken during 2014/15;
- A review of compliance with Treasury and Prudential Limits for 2014/15.

Key Changes to the Treasury and Capital Strategies

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts", making the Support, Financial Strength and Viability ratings redundant. This process may commence during this financial year. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.

As a result of these rating agency changes, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that we have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, we will continue to utilise CDS prices as an overlay to ratings in our new methodology

3 Economic update

3.1 Economic performance to date and outlook (provided by our Treasury Advisors - Capita)

3.1.1 U.K.

After strong UK GDP quarterly growth of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1 and 0.9% in Q2 2014 (annual rate 3.2% in Q2), it appears very likely that strong growth will continue through 2014 and into 2015 as forward surveys for the services and construction sectors, are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though the latest figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster through the initial threshold of 7%, set by the Monetary Policy Committee (MPC) last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.5% in May and July, the lowest rate since 2009. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1%. Overall, markets are expecting that the MPC will be cautious in raising Bank Rate as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q1 or Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The return to strong growth has also helped lower forecasts for the increase in Government debt by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

3.1.2 U.S.

In September, the Federal Reserve continued with its monthly $10bn reductions in asset purchases, which started in December 2014. Asset purchases have now fallen from $85bn to $15bn and are expected to stop in October 2014, providing strong economic growth continues. First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in Q2 to 4.6% (annualised).

The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions.

3.1.3 Eurozone

The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt).
Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed.

3.1.3 China and Japan

Japan is causing considerable concern as the increase in sales tax in April has suppressed consumer expenditure and growth. In Q2 growth was -1.8% q/q and -7.1% over the previous year. The Government is hoping that this is a temporary blip. As for China, Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has raised fresh concerns. There are also major concerns as to the creditworthiness of much bank lending to corporates and local government during the post 2008 credit expansion period and whether the bursting of a bubble in housing prices is drawing nearer.

3.2 Interest rate forecasts

The Council’s treasury advisor, Capita Asset Services, has provided the following forecast:

	NOW	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
BANK RATE	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	2.00	2.25	2.50
3 month LIBID	0.50	0.50	0.60	0.80	0.90	1.10	1.30	1.40	1.60	1.90	2.10	2.10	2.30	2.40	2.60
6 month LIBID	0.65	0.70	0.80	1.00	1.10	1.20	1.40	1.50	1.80	2.00	2.20	2.30	2.50	2.70	2.80
12 month LIBID	0.93	0.90	1.00	1.20	1.30	1.40	1.70	1.80	2.10	2.20	2.30	2.40	2.60	2.80	3.00
5 yr PWLB	2.40	2.50	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.50	3.50	3.50
10 yr PWLB	3.00	3.20	3.40	3.50	3.60	3.70	3.80	3.90	4.00	4.10	4.10	4.20	4.20	4.30	4.30
25 yr PWLB	3.70	3.90	4.00	4.10	4.30	4.40	4.50	4.60	4.70	4.70	4.80	4.80	4.90	4.90	5.00
50 yr PWLB	3.70	3.90	4.00	4.10	4.30	4.40	4.50	4.60	4.70	4.70	4.80	4.80	4.90	4.90	5.00

Capita Asset Services undertook a review of its interest rate forecasts in mid August, after the Bank of England's Inflation Report. By the beginning of September, a further rise in geopolitical concerns, principally over Ukraine but also over the Middle East, had caused a further flight into safe havens like gilts and depressed PWLB rates further. However, there is much volatility in rates as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 1 of 2015.

Our PWLB forecasts are based around a balance of risks. However, there are potential upside risks, especially for longer term PWLB rates, as follows: -

- A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds and into equities.

- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Downside risks currently include:

- The situation over Ukraine poses a major threat to EZ and world growth if it was to deteriorate into economic warfare between the West and Russia where Russia resorted to using its control over gas supplies to Europe.

- UK strong economic growth is currently dependent on consumer spending and the unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014.

- A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth beyond 2014.

- Weak growth or recession in the UK's main trading partners - the EU and US, inhibiting economic recovery in the UK.

- A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.

- A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.

- Recapitalising of European banks requiring more government financial support.

- Lack of support by populaces in Eurozone countries for austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.

- Italy: the political situation has improved but it remains to be seen whether the new government is able to deliver the austerity programme required and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.

- France: after being elected on an anti austerity platform, President Hollande has embraced a €50bn programme of public sector cuts over the next three years. However, there could be major obstacles in implementing this programme. Major overdue reforms of employment practices and an increase in competiveness are also urgently required to lift the economy out of stagnation.

- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.

- Heightened political risks in the Middle East and East Asia could trigger safe haven flows back into bonds.

- There are also increasing concerns that the reluctance of western economies to raise interest rates significantly for some years, plus the huge QE measures which remain in place (and may be added to by the ECB in the near future), has created potentially unstable flows of liquidity searching for yield and therefore heightened the potential for an increase in risks in order to get higher returns. This is a return of the same environment which led to the 2008 financial crisis.

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2014/15 was approved by this Council on 3 March 2014.

- There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Members should note: that in the case of Lloyds TSB our current bankers, that as well as allowing up to £5m fixed term investment in that one institution that there is flexibility to hold, in current account balances at Lloyds, up to £1m 'cash' on any one day. This is implicit in the 2014/15 Strategy.

5 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.

5.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget and draws together the main strategy elements of the capital expenditure plans (above), highlighting the original capital programme, and the expected financing arrangements of this capital expenditure. Any borrowing need increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR).

Capital Expenditure	**2014/15 Original Estimate £'000**	**2014/15 Revised Estimate £'000**
Total Unsupported spend	4,566	2,684
Financed by:		
Capital receipts	2,034	1,336
Capital grants	462	371
Revenue	2,070	872
S106	0	105
Total financing	4,566	2,684
Borrowing need	0	0

5.3 There have been no changes to the Treasury or Prudential Indicators.

The Director of Resources reports that no difficulties are envisaged for the current or future years in complying with prudential indicators.

The Treasury and Prudential monitoring information is reported below;

	Original £'000	Q1 £'000	Q2 £'000
Treasury Indicators			
Authorised limit for external debt	3,000	3,000	3,000
Operational boundary for external debt	303	303	303
External Debt	0	0	0
Long term Leases	303	303	303
Investments	13,195	20,600	19,700
Net Borrowing	**12,892**	**20,297**	**19,397**
Prudential Indicators			
Capital Expenditure	4,566	3,364	2,684
Capital Financing Requirement (CFR)*	1,428	1,428	1,428
Annual change in CFR*	-225	-225	-225
In year borrowing requirement	0	0	0
Under/(over)borrowing	1,125	1,125	1,125
Ratio of financing costs to net revenue stream*	0.30%	0.25%	0.20%
Incremental impact of capital investment decisions:			
Increase in Council Tax (band change per annum)	£1.91	£1.22	£0.97

6 Investment Portfolio 2014/15

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 3, 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 0.5% Bank Rate. Indeed, 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. Given this risk environment, investment returns are likely to remain low.

The Treasury Management Strategy Statement (TMSS) for 2014/15, which includes the Annual Investment Strategy, was approved by the Council on 3 March 2014. It sets out the Council's investment priorities as being:

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

The Council will also aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity. 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 periods up to 12 months, with highly credit rated financial institutions, using our suggested creditworthiness approach, including sovereign credit rating and Credit Default Swap (CDS) overlay information.

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30 September 2014. Investment rates available in the market have continued at historically low levels. The average level of funds available for investment purposes during the quarter was £20.1m. These funds were available on a temporary basis, and 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 holds £17.3m core cash balances for investment purposes (i.e. funds available for more than one year).

Investment performance for quarter ended 30 September 2014

Benchmark	Benchmark Q1	Actual Q1	Interest Earned Q1 £	Benchmark Q2	Actual Q2	Interest Earned Q2 £
Overnight	0.34%	0.39%	5,561	0.35%	0.35%	17,192
7 day	0.34%	-	0	0.35%	-	-
1 month	0.36%	-	0	0.37%	-	-
3 month	0.40%	-	0	0.42%	0.70%	28,384
6 month	0.51%	0.70%	4,375	0.55%	0.78%	10,767
12 month	0.82%	0.98%	4,862	0.88%	0.99%	7,502
Other	-	-	-		5.03%	16,764
Total			**14,798**			**80,609**

As illustrated, the Council continues to outperform the benchmark. The Council's budgeted investment return for 2014/15 is £0.200m and performance for the year to date is in line with the budget. The Council held £19.700m (£20.600m Q1) of investments as at 30 September 2014 and the investment portfolio yield for the first 6 months of the year for investments is 0.78% (0.70% Q1) as shown in Appendix 2. The weighted average rate of interest for Q2 is 0.86% (0.70%Q1) has been achieved and compares to the benchmark *7* day libid of 0.47209% *(*0.33875% Q1).

The above figures exclude monies currently held in the Escrow accounts which currently stand at £0.212m.

Investment in Local Authority Property Fund

During the period the Council invested £1m in the CCLA Property Fund.
Interest is receivable on a quarterly basis. Interest received for the month June amounted to £4,191 equating to an annualised interest rate of 5.1%.

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2014/15.

Treasury Officers continue to mitigate investment risk in accordance with Treasury Management Practices.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during this financial year. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.

It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of support that has been built into ratings through the financial crisis. The eventual removal of implied Government support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

As a result of these rating agency changes, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that we have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, we will continue to utilise CDS prices as an overlay to ratings in our new methodology.

7 Borrowing

The Council’s strategy is not to undertake any long term borrowing although temporary borrowing for cash flow purposes, on a short term basis, may occasionally take place. The Council has recognised this possibility by setting its Authorised Borrowing Limit for 2014/15 at £3m.

During the six months to 30 September, no borrowing – either long or short term was undertaken. However, credit arrangements such as finance leases are classified as borrowing under the capital control arrangements for local authorities. The Council procures replacement vehicles and certain other assets (printers, fuel tanks) through finance lease arrangements which count as credit arrangements. The liability to pay the finance leases are disclosed as other long term liabilities in the Council’s accounts. The operational limit that has been approved for 2014/15 is £0.303m (relates to finance lease principal).

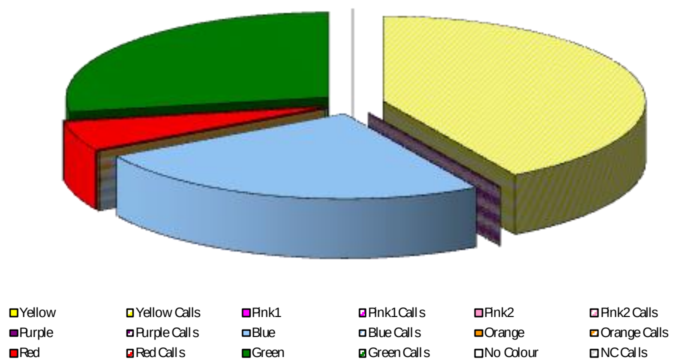
West Lindsey District Council

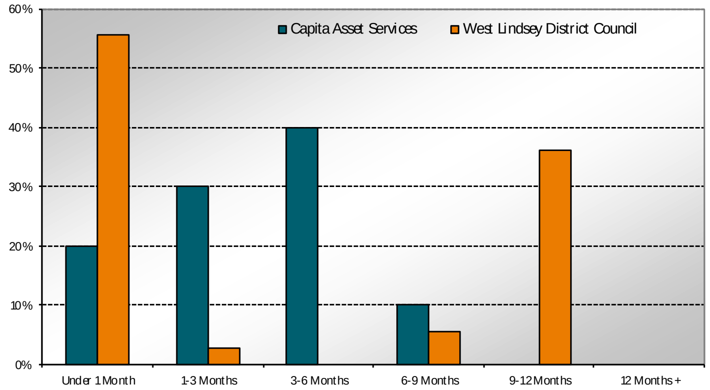
Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
MMF Insight	5,000,000	0.43%		MMF	AAA	0.000%
MMF LGIM	2,500,000	0.44%		MMF	AAA	0.000%
Lloyds Bank Plc	500,000	0.98%	11/10/2013	10/10/2014	A	0.002%
Lloyds Bank Plc	2,000,000	0.70%	17/04/2014	17/10/2014	A	0.004%
Lloyds Bank Plc	500,000	0.70%	19/06/2014	19/12/2014	A	0.019%
Lloyds Bank Plc	1,000,000	0.95%	19/06/2014	17/06/2015	A	0.062%
Lloyds Bank Plc	500,000	0.95%	18/08/2014	14/08/2015	A	0.076%
Nationwide Building Society	1,000,000	0.98%	15/09/2014	15/09/2015	A	0.083%
Goldman Sachs International Bank	5,000,000	1.03%	16/09/2014	16/09/2015	A	0.083%
Total Investments	**£18,000,000**	**0.72%**				0.034%
CCLA LAPF	**£1,000,000**					
Total Investments with CCLA	**£19,000,000**					

West Lindsey District Council

Portfolio Composition by Capita Asset Services' Suggested Lending Criteria





Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

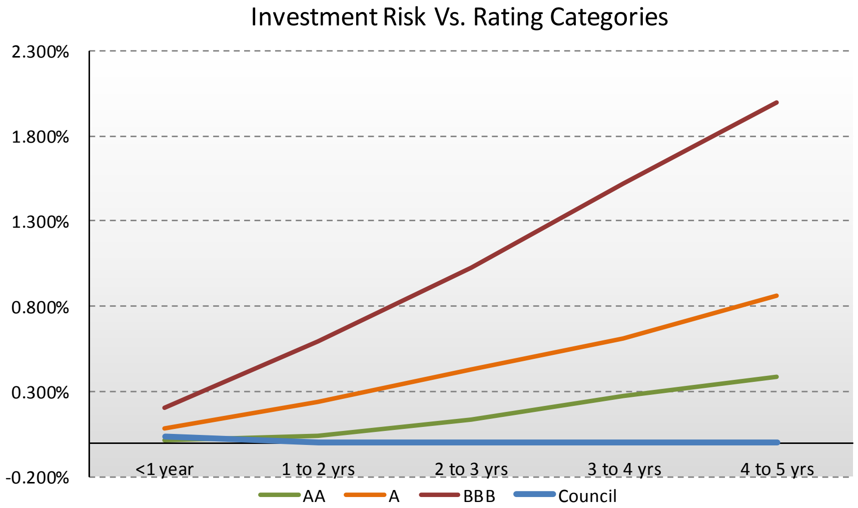
Portfolios weighted average risk number = 3.11

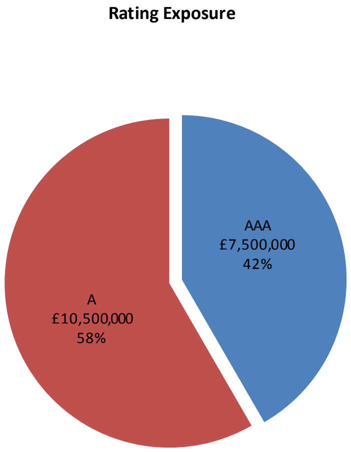
WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

	% of Portfolio	Amount	% of Colour in Calls	Amount of Colour in Calls	% of Call in Portfolio	WARoR	WAM	WAM at Execution	Excluding Calls/MMFs/EMMFs WAM	Excluding Calls/MMFs/EMMFs WAM at Execution
Yellow	41.67%	£7,500,000	100.00%	£7,500,000	41.67%	0.43%	0	0	0	0
Pink1	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Pink2	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Purple	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Blue	25.00%	£4,500,000	0.00%	£0	0.00%	0.81%	111	263	111	263
Orange	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Red	5.56%	£1,000,000	0.00%	£0	0.00%	0.98%	350	365	350	365
Green	27.78%	£5,000,000	0.00%	£0	0.00%	1.03%	351	365	351	365
No Colour	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
	100.00%	**£18,000,000**	**41.67%**	**£7,500,000**	**41.67%**	**0.72%**	**145**	**187**	**248**	**321**

West Lindsey District Council

Investment Risk and Rating Exposure





Historic Risk of Default

Rating/Years	<1 year	1 to 2 yrs	2 to 3 yrs	3 to 4 yrs	4 to 5 yrs
AA	0.017%	0.038%	0.137%	0.271%	0.384%
A	0.087%	0.237%	0.425%	0.610%	0.861%
BBB	0.201%	0.595%	1.025%	1.519%	2.000%
Council	0.034%	0.000%	0.000%	0.000%	0.000%

Historic Risk of Default

This is a proxy for the average % risk for each investment based on over 30 years of data provided by Fitch, Moody's and S&P. It simply provides a calculation of the possibility of average default against the historical default rates, adjusted for the time period within each year according to the maturity of the investment.

Chart Relative Risk

This is the authority's risk weightings compared to the average % risk of default for “AA”, “A” and “BBB” rated investments.

Rating Exposures

This pie chart provides a clear view of your investment exposures to particular ratings.