EXE 13 11 12
Item 11

TREASURY MANAGEMENT 2012/13 - Treasury Management Strategy Statement and Annual Investment Strategy Mid-Year Review Report

EXECUTIVE MEMBER:	Councillor Gillian Troughton
LEAD OFFICER:	Darienne Law, Head of Corporate Resources
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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 security and liquidity initially before considering maximising 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 requirements. 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 objectives.

As a consequence 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. "

Recommendations:
Executive is asked to:
1. Note the Mid-Year Review
2. Note the forecast additional investment income of £59,237 for the second quarter ended 30th September 2012, subject to current economic conditions prevailing to year end.

1. INTRODUCTION

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management was adopted by this Council on 14 December 2009.

The primary requirements of the Code are as follows:

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

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

c) 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** (this report) and an Annual Report (stewardship report) covering activities during the previous year.

d) 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.

e) 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 the Audit Committee:

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

- An economic update for the first six months of 2012/13 (paragraph 2);
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy (paragraph 3);
- The Council's capital expenditure (prudential indicators – paragraph 4);
- A review of the Council's investment portfolio for 2012/13 (paragraph 5);
- A review of the Council's borrowing strategy for 2012/13 (paragraph 5);
- A review of any debt rescheduling undertaken during 2012/13 (not applicable);
- A review of compliance with Treasury and Prudential Limits for 2012/13 (paragraph 4)

The Head of Corporate Resources can report that the basis of the Treasury Management Strategy and the PIs have not materially changed since approved by Council on 23rd February 2012.

2. ECONOMIC UPDATE

2.1 Economic Performance to date

Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession have successively been reduced making the Chancellor's ability to reduce the deficit very difficult. The UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone. The uncertainty created by the continuing Eurozone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China. As Europe is our biggest export market, factors outside the UK's control are contributing to poor economic performance.

In the UK, consumer spending is key to economic growth. However, consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking a toll. Whilst inflation has fallen considerably, the UK national income (Gross Domestic Product – GDP) fell by 0.4% in the quarter to 30th June, the third quarterly fall in succession and means the UK is in recession.

This weak recovery has caused social security payments to remain elevated and tax receipts to be depressed. Consequently, the Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed further into the future. The Monetary Policy Committee (MPC) has kept Bank Rate at 0.5% throughout the period to aid growth, while quantitative easing was increased by £50bn to £375bn in July to try to maintain a liquid interbank market to see cash reaching business and the consumer. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

2.2 Outlook for the next six months of 2012/13

The general outlook for the UK economy is that economic performance should improve from a low level, but is unlikely to be strong. Growth (GDP) should be positive in quarter 3 of 2012, breaking the recession, but remain low or negative in future quarters. The full impact of the Comprehensive Spending Review is yet to be felt, which will depress growth, although employment and unemployment data have been better than expectations. Whilst inflation has fallen, the consumer remains in an indebted position, with real incomes falling and concerns over job security. Judged against other countries our performance is good, but our key risks surround events outside the UK's control, particularly the Euro-zone debt crisis and forthcoming fiscal tightening in the US. Against this backdrop UK monetary policy will remain loose (a low Bank Rate and further Quantitative Easing), in the hope that the world economy (particularly the Euro-zone) begins to recover and have a positive effect on the UK.

The overall balance of risks is, therefore, weighted to the downside:

- **We expect low growth in the UK to continue, with Bank Rate unlikely to rise in the next 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.**
- **The expected longer run trend for PWLB borrowing rates is for them to eventually rise, primarily due to the need for a high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, tempering any increases in yield.**
- **The rates forecasted below at 2.3 which was provided by our Treasury Consultants, Sector, is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Eurozone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.**

2.3 Sector's interest rate forecast

	17.9.12 actual	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
3m LIBID	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.70	0.90	1.10	1.40
6m LIBID	0.85	0.85	0.85	0.85	0.85	0.85	1.00	1.10	1.30	1.50	1.80
12m LIBID	1.30	1.30	1.30	1.30	1.40	1.50	1.70	1.90	2.10	2.30	2.60
5yr PWLB	1.89	1.50	1.50	1.50	1.60	1.70	1.80	1.90	2.00	2.10	2.30
10yr PWLB	2.91	2.50	2.50	2.50	2.60	2.70	2.80	2.90	3.00	3.20	3.30
25yr PWLB	4.15	3.70	3.70	3.70	3.80	3.80	3.90	4.00	4.10	4.20	4.30
50yr PWLB	4.32	3.90	3.90	3.90	4.00	4.00	4.10	4.20	4.30	4.40	4.50

3. Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2012/13 was approved by this Council on 23rd February 2012.

There are no policy changes to the TMSS for 2012/13 required at this time.

4. 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.

4.1 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 set in February 2012.

Capital Expenditure	2012/13 Original Estimate £000's	Current spend as at 30th September 2012 £000's	2012/13 Revised forecast spend £000's
Total	1,544	599	1,722

As detailed in the table above, a gross capital programme budget for 2012/13 of £1,543,649 was approved by Council on 23rd February 2012. This was later increased by £80,000 to £1,623,649 in relation to the addition of Moor Row Play Area and further amended by £303,707 to account for slippage at outturn (31st March 2012). A further request of £30,000 for works on the former Kells school site was approved on 6th September 2012 bringing the amended Capital Programme budget to £1,957,356. The forecast spend position for the financial year 2012/13 as at 30th September 2012 is capital expenditure of £1,721,839. A detailed Capital Programme 2012/13 Budget Monitoring Report as at Quarter 2 is presented elsewhere on this agenda.

4.2 Changes to the Financing of the Capital Programme

The table overleaf draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported (i.e. paid for in year of spend) and unsupported (not paid for in year of spend) elements of the capital programme, and the expected financing arrangements of this capital expenditure. Any borrowing element in the table would increase the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this would be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). Any direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2012/13 Original Estimate £000's	Current spend as at 30th September 2012 £000's	2012/13 Revised forecast spend £000's
Supported	1,544	599	1,722
Unsupported	0	0	0
Total spend	**1,544**	**599**	**1,722**
Financed by:			
Useable Capital receipts	1,234	399	1,321
Other Reserves & Contributions	0	0	0
External Funding	310	200	401
Total financing	**1,544**	**599**	**1,722**
Borrowing need	**0**	**0**	**0**

4.3 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR), External Debt and the Operational Boundary

The table at 4.5 below 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.**

4.4 Prudential Indicator – Capital Financing Requirement (CFR) (Underlying need to borrow)

We are on target to achieve the amended forecast Capital Financing Requirement as outlined in the table below.

4.5 Prudential Indicator – External Debt / the Operational Boundary

	2012/13 Amended Estimate £000's	2012/13 Revised Estimate £000's
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	8,419	8,884
Net movement in CFR	**0**	**465**
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	5,000	5,000
Other long term liabilities*	6,827	7,366
Total debt 31 March	**11,826**	**12,366**

**On balance sheet PFI schemes and finance leases etc.*

The above table shows an increase in the CFR (underlying need to borrow) from £8,419k to £8,884k and an increase in the other long term liabilities from £6,827k to £7,366k. This is not an increase in these levels as such, but a difference in the way we account for the leasing arrangements of our vehicles which can run from 1 to 5 years. For example, the balance of £6,827k will have included leases of vehicles at the end of their contract (at year 5 so little/no liability left). Therefore, when these contracts expire and are renewed in the current year (i.e.

back at year 1 so full 5 year liability left) would show as an additional indebtedness for the full contract (years 1-5).

4.6 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. Net 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 2012/13 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 and necessary.

Limits to Borrowing Activity	2012/13 Amended Estimate £000's	2012/13 Revised Estimate £000's
Gross borrowing	5,000	5,000
Plus other long term liabilities*	6.827	7,366
Less investments	(17,133)	(18,026)
Net borrowing	**(5,306)**	**(5,660)**
CFR (year-end position)	**8,419**	**8,884**

**Includes on balance sheet PFI schemes and finance leases.*

The Head of Corporate Resources reports that no difficulties are envisaged for the current year 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. This limit needs to be set and revised by Members. It reflects the level of borrowing which, while not desirable, 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	2012/13 Original Indicator	2012/13 Revised Indicator
Borrowing	9,000	9,000
Other long term liabilities*	8,000	8,000
Total	17,000	17,000

**Includes on balance sheet PFI schemes and finance leases.*

5 Investment Portfolio 2012/13

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 2, 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. The continuing Euro zone sovereign debt crisis, and its potential impact on banks, prompts a low risk and short term strategy. This involved placing temporary restrictions on our counterparty list, only using the highest rated Banks and highly secure Money Market Funds. Given this risk adverse environment and these restrictions on our counterparty list, investment returns are likely to remain low.

The Treasury Management budget was set by Council alongside other revenue budgets on 23rd February 2012. The budget was prepared assuming that interest rates would remain at the current low level for the foreseeable future however, as expected in previous years, there was still a possibility that interest rates could rise. With this expectation, the budget for Treasury Management interest was set at £227,822 incorporating a reduction/pressure of £25,000 to reflect the Councils anticipated capacity to generate income from possible future investments, given the market conditions and forecasts at the time.

However, the full year forecast for investment interest at 30th September 2012 is £287,059 resulting in a possible favourable variance of £59,237, if current market conditions prevail to the end of the financial year.

This is shown in the table below:

Anticipated Investment Return 2012/13:

Budget £	Received to Date	Interest on current outstanding investments	Forecast of expected investments to 31/03/13	Total Forecast position as at 31/03/13	Variance £
227,822	56,306	165,947	64,806	287,059	59,237

The Council held £22.2m of investments as at 30th September 2012, of this £9.7m were held in instant access Call accounts/Money Market Funds (and therefore would be deemed as cash equivalent within the year end accounts) the remainder being held in fixed term deposits for period not exceeding 1 year. The average investment portfolio yield for the first six months of the year is 1.14% against current base rate of 0.5%.

The Head of Corporate Resources confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2012/13.

A full list of investments held as at 30th September 2012 is presented at Appendix A.

5.1 Investment Counterparty criteria

The current counterparty criteria is under regular review, however no further amendments to the Treasury Management and Investment Strategies are sought at this time. The revised draft Treasury Management and Investment Strategy for 2013/14 will be presented and approved prior to the start of the new financial year.

5.2 Borrowing

The Council's capital financing requirement (CFR) for 2012/13 is £8.884m. The CFR denotes the Council's underlying need to borrow for capital purposes. The Council's underlying need to borrow is supported by finance leases for both the Copeland Centre (PFI) and vehicles.

The Council's debt portfolio contains one remaining Market Loan of £5 million. We continually assess the position of this loan with our Treasury Consultants, Sector, to see whether we are securing the best terms for the Council. At the current time, the advice is to leave this loan in its present form, as the penalty for repaying early would be prohibitive.

In the event that borrowing is necessary, the Head of Corporate Resources, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time and taking into account contemporaneous forecasts. Executive agreement would be sought and if necessary, an amendment to the Treasury Management Strategy would be sought from Council.

The general trend has been a reduction in interest rates since April, across all maturity bands.

6. STATUTORY OFFICER COMMENTS

The Monitoring Officer's comments are:

The Section 151 Officer's comments are: Comments included in the report

EIA Comments: EIA completed as part of the budget setting process

Policy Framework: This is consistent with our Treasury Management Strategy

Other consultee comments, if any:

7. HOW WILL THE PROPOSALS BE PROJECT MANAGED AND HOW ARE THE RISKS GOING TO BE MANAGED?

The Treasury Management function is continually monitored and is reported to Executive throughout the year. It also forms part of the revenue monitoring report distributed to Heads of Service on a monthly basis. The principles set out in the Treasury Management Strategy ensure that we have a balance between security and liquidity of funds and the yield achieved, with security being the principle concern particularly in the current economic climate.

8. WHAT MEASURABLE OUTCOMES OR OUTPUTS WILL ARISE FROM THIS REPORT?

As stated above the position will continue to be closely monitored and the Treasury Management Strategy 2013/14 will and presented to Full Council for approval prior to the start of the new financial year.

List of Appendices

Appendix A: Temporary investments as at 30th September 2012.

List of Background Documents:

Treasury Management Strategy 2012/13 incorporating the Annual Investment Strategy 2012/13 & Minimum Revenue Provision Statement 2012/13 to Council 23rd February 2012, Capital Programme 12/13 Budget Monitoring Report (Quarter 2).

Appendix A

TEMPORARY INVESTMENTS AT 30/09/12

	AMOUNT	PERIOD OF LOAN	VALUE DATE	MATURITY DATE	RATE	BASE RATE
RBS CALL	1,984,000	CALL			0.80%	
RBS MMF	1,319,000	CALL			0.44%	
IGNIS MMF	4,900,000	CALL			0.63%	
LLOYDS DEPOSIT	4,000,000	364 DAYS	15/02/2012	13/02/2013	3.10%	
BOS DEPOSIT	1,000,000	3 MONTHS	18/06/2012	30/10/2012	1.65%	
BOS DEPOSIT	2,500,000	3 MONTHS	27/06/2012	30/10/2012	1.65%	
RBS 95 DAY NOTICE	5,000,000	95 DAYS	27/06/2012	01/10/2012	1.25%	
INSIGHT MMF	1,500,000	CALL			0.55%	
TOTAL	**22,203,000**				1.37%	0.50%

SUMMARY	BALANCE	LIMIT		AVAILABLE HEADROOM
BANK OF SCOTLAND/LLOYDS	7,500,000	10,000,000	*	2,500,000
RBS MMF	1,319,000	5,000,000		3,681,000
RBS	6,984,000	10,000,000	*	3,016,000
IGNIS MMF	4,900,000	5,000,000		100,000
BLACKROCK MMF	0	5,000,000		5,000,000
INSIGHT MMF	1,500,000	5,000,000		3,500,000
	22,203,000	**40,000,000**		**17,797,000**

* Investment limit of £7.5m, however ultimate limit of upto £10m with prior approval of S151 and for short term investments only.