TREASURY MANAGEMENT 2009/10 - Mid Year Prudential Indicators and Treasury Management Monitoring Report

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Summary:

Recommendations set out in revised second edition, released this month, of the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, include the production of a mid- year report on the Council's Treasury Management activities. This report fulfils this recommendation as well as setting out the Council's prudential indicators as at 30 September 2009.

Recommendations:
That Members note the Treasury Management activities for the period ended 30 September 2009, including the Prudential Indicators detailed in Appendix A.

1. INTRODUCTION

1.1. Members will recall the Prudential Code (the Code), introduced in the Local Government Act 2003, included the requirement that reporting procedures to be implemented to monitor the progress and status of the capital expenditure plans. The Code also requires that Councils use a set of Prudential Indicators in order to ensure that the capital investment plans of the Council are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability.

1.2. A revised second edition of the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, was released in late November. This included a recommendation for the production of a mid- year report on the Council's Treasury Management activities. Half yearly reporting of the Treasury Management operation is also set out in the Council's Financial Regulations. This report fulfils this requirement along with setting out the Council's Prudential Indicators as at 30 September 2009.

1.3. An update to the Treasury Management Strategy for 2009/10 (originally agreed by Council on 24 February 2009) was presented to Executive on 25 August 2009 and to Council on 8th December. The Treasury Management

1.4. Elected Members were invited to a Treasury Management Training Session provided by Butlers Treasury Management (the Council's specialist advisers) on 23rd November and this was well attended.

1.5. There are a number of very recent treasury developments; as previously noted, the revised Codes (Prudential and Treasury Management) were released in late November. The timing of this report means advisers and Officers have not yet had time to completely assimilate the full implications of the revisions, however, where possible this report seeks to address anticipated revisions:

a. The current world-wide crisis in the financial markets, and resulting banking failures, has prompted a professional discussion (through a revision to the CIPFA Treasury Management Code of Practice) regarding the frequency and detail of treasury management reporting to elected Members. Previous requirements were for a forward looking strategy in advance of the year and a backward looking annual report after the year. The guidance covering the new reporting structure recommends additional semi-annual Member reporting.

b. This professional guidance is also likely to require greater Member involvement in the consideration and benchmarking of security, liquidity and return in the investment portfolio. This will be considered when the professional guidance has been fully reviewed.

c. The direct consequence of the difficulties in the financial markets has been the regular review and amendment of the investment strategy, primarily the approach to investment counterparty selection.

1.6. Executive is asked to note that the basis of the treasury management strategy, the investment strategy and the PIs are not materially changed, except as detailed below.

2. ECONOMIC SITUATION FOR THE 6 MONTHS TO 30 SEPTEMBER 2009 – A SUMMARY

2.1. The outlook for the UK economy is still very unclear and talk of green shoots of recovery may be premature. During the second quarter of the year the contraction of GDP sunk to a year-on-year rate of (minus) 5.6%.

2.2. Some economic data has become less pessimistic in recent months, but the improvement has not been broad-based and is patchy at best. The bulk of the favourable news has come from surveys of activity and sentiment in the manufacturing and service sectors.

2.3. The prospects of cuts to public spending programmes in the years ahead, a limited recovery in the trade balance while global activity remains low key and moderate growth in corporate investment do not indicate a strong rebound in economic activity.

2.4. When the limited ability of the household sector to increase its spending activity while its level of indebtedness remains close to historic highs is taken into account, any upturn in growth can be expected to be slow and a return to long-run potential protracted.

2.5. Weak growth will suppress domestic inflation pressures. Increases in labour costs should remain subdued as the pool of available labour remains comparatively large. In addition, slow retail sales growth implies intense competitive pressures on the High Street and aggressive discounting by retailers intent upon holding market share or winning it from domestic and international rivals.

2.6. The main threat, as in much of the past five years, will come from external factors over which the Bank of England has no real control. Here, the outlook is mixed but the low point of the cycle has probably passed.

2.7. In the mean time, UK inflation performance will remain benign and pressure upon the Monetary Policy Committee of the Bank of England to raise interest rates should be modest. Where the pressure to reverse "easy" policy will be most prominent is in the approach to Quantitative Easing (QE).

2.8. Once the threat of deflation has lifted – and the dangers of this happening have diminished markedly in the past few month – the Bank of England may see the need to reverse some, if not all, of this experimental relaxation in monetary conditions for fear that it could prove highly inflationary over the longer term.

2.9. The reversal of QE will require additional sales of gilt-edged securities to non-bank institutions. Added to the already heavy schedule of gilt issues required to fund the massive public sector deficit, these sales will maintain upward pressure upon yields and long-term interest rates, a situation that promises an upward sloping yield curve in the years ahead, although this is likely to flatten as the Bank rate rises.

Medium-Term Rate Estimates (*source :Butlers Treasury Management)*

Annual Average %	**Bank Rate**	**Money Rates**		**PWLB Rates***		
		3 month	**1 year**	**5 year**	**20 year**	**50 year**
2008/09	3.9	5.0	5.3	4.2	4.8	4.5
2009/10	0.5	0.9	1.6	3.4	4.7	4.8
2010/11	1.0	1.5	2.6	4.0	5.0	5.2
2011/12	2.0	2.5	3.3	4.3	5.3	5.3
2012/13	4.5	4.8	5.3	5.3	5.5	5.3

* Borrowing Rates

3. TREASURY MANAGEMENT FOR THE 6 MONTHS TO 30 SEPTEMBER 2009

3.1. The Council still has the one remaining Market Loan in its debt portfolio, of £5 million. We continually assess the position of this loan with our Treasury Consultants, Butlers, 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.

3.2. In December 2008 and January 2009 £9Million of the Councils core balances were invested for a period of 364 days at an average interest rate of 3.17%. This was designed to lock in the best interest rates available at that time for as much of the 2009/10 year as was prudent and accounts for £216k of the interest achieved to date.

3.3. Due to the uncertainty in the financial markets from November 2008, acting within the Treasury Management Strategy, the pool of available counter-parties (i.e. those financial institution/organisations that we can place money with), within the approved criteria, was restricted to safer instruments and institutions. Currently this involves the use of AAA rated Money Market Funds and institutions with higher credit ratings than those outlined in the investment strategy or which are provided support from the Government. In addition to this, since January 2009, all investments have been made for relatively short periods (3 to 4 months).

3.4. The Executive will recall the current year update included in the Treasury Management 2008/09 Annual Performance Report (August Executive meeting) and the necessary extension of lending limits as a consequence of the highly rated and supported Banks are offering relatively low interest rates because they know that lenders are being ultra cautious in their choice of counter-parties and they are confident of obtaining their required level of borrowing, without having to offer particularly attractive rates.

3.5. During the period to 30 September 2009 interest of £273k was received. This equates to an average rate of return on investments of 1.96% compared to average base rate of 0.5%. The current forecast for investment interest for 2009/10 was is £485k compared to the annual budget of £540k, a shortfall of £55k. This has been reflected in the quarterly budget monitoring reports to Executive.

3.6. A list of investments held at 30 September 2009 is attached at Appendix B.

4. PROSPECTS FOR THE REMAINDER OF 2009/10 AND THEREAFTER

4.1. Looking forward to the remainder of 2009/10, shorter-term interest rates, on which investment decisions are based, are likely to remain subdued for some time, and a combination of counterparty risk and lack of value in longer term deposit rates are likely to see the continuation of an investment policy of maintaining shorter term, high quality investments.

4.2. However it is expected that the financial markets will begin to return to normality over the course of 2010/11. Counterparty risk should become more subdued and with the expectation of an increasing Bank Rate, value will begin to return to longer term investments. If there is clear evidence of this taking place, an amendment to the investment strategy to cautiously extend investments may be considered, and indeed appropriate.

4.3. The Council's investment strategy is safeguarding the re-payment of the principal and interest of its investments on time – the investment return being a secondary objective. Following on from the economic background above, the current investment climate has one over-riding risk consideration, that of counterparty risk. The current counterparty criteria is under regular review - Members will recall that the Treasury Management Annual Report for 2008/09 presented to Executive in August increased the lending maximum in response to the need for flexibility – however no further amendments to the Treasury Management and Investment Strategies are sought at this point in time.

4.4. The situation regarding borrowing remains unchanged from that reported to the August Executive and the Council will continue to take a cautious approach. In the event that borrowing is necessary, the Head of Finance and MIS, 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 any amendment to the Treasury Management Strategy would be sought from Council.

5. IMPACT ON CORPORATE PLAN

5.1. By ensuring that the Council utilises its resources effectively, Treasury Management supports the delivery of the Corporate Plan.

List of Appendices

Appendix A: Prudential Indicators as at 30 September 2009
Appendix B: Investments as at 30th September 2009

List of Background Documents: Treasury Management Strategy Statement, Investment Strategy and Minimum revenue Provision Strategy Report 2009/10 to Full Council 24th February 2009, Treasury Management Annual Report 2008/09 to Executive 25 August 2009

List of Consultees: Corporate Team, Head of Finance

CHECKLIST FOR DEALING WITH KEY ISSUES

Please confirm against the issue if the key issues below have been addressed . This can be by either a short narrative or quoting the paragraph number in the report in which it has been covered.

Impact on Crime and Disorder	None
Impact on Sustainability	None
Impact on Rural Proofing	None
Health and Safety Implications	None
Project and Risk Management	None
Impact on Equality and Diversity Issues	None
Children and Young Persons Implications	None
Human Rights Act Implications	None
Monitoring Officer Comments	No legal issues arise from the report
Section 151 Officer Comments	No further comments to add.

Please say if this report will require the making of a Key Decision YES/~~NO~~

KEY PRUDENTIAL INDICATORS

This Appendix to the report provides an update, as at 30th September 2009, on:

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

Capital Expenditure (PI)

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure by Service	2009/10 Revised Estimate	Change from Strategy	2010/11 Revised Estimate	Change from Strategy	2011/12 Revised Estimate	Change from Strategy
Total	7,848	2,475	2,353	312	422	124

The reason for this change in capital expenditure estimate from that agreed in February 2009 relates to an increase in external funding to support the capital programme. Executive will remember the Quarter 2 monitoring report (November meeting) reporting over 50% of the capital programme is supported by external resources, representing good value for money in relation to the use of the Council's resources to deliver the capital programme.

Re-profiling of some schemes over the three year period accounts for the revisions in the strategy for 2010/11 and 2011/12. This will be further updated after the Resources Planning Working Group considers the draft capital programme for the following three years as it prepares the draft budget proposal for Executive to consider in February, before recommending to Council, the budget for 2010/11.

Impact of Capital Expenditure Plans

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 original supported and unsupported elements of the capital programme, and the expected financing arrangements for this capital expenditure. The borrowing element of the table increases the underlying indebtedness in the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2009/10 Revised Estimate	Change from Strategy	2010/11 Revised Estimate	Change from Strategy	2011/12 Revised Estimate	Change from Strategy
Supported	7,848	2,475	2,353	312	422	124
Unsupported						
Total spend	7,848	2,475	2,353	312	422	124
Financed by:						
Capital receipts	3,292	192	885	284	392	124
Capital grants	4,479	2,374	1,468	28	30	0
Capital Reserves	77	-91				
Revenue						
Total Financing	7,848	2,475	2,353	312	422	124
Borrowing Need	**0**	**0**	**0**	**0**	**0**	**0**

Changes to the Capital Financing Requirement (PI), External Debt and the Operational Boundary (PI)

The table shows the CFR, which is the underlying external need to borrow for a capital purpose. It is increased each year by any new borrowing need (as above), and decreased by any statutory revenue charge for the repayment of debt (the Minimum Revenue Provision).

The table also shows the expected debt position over the period. This is termed the Operational Boundary.

	2009/10 Revised Estimate	Change from Strategy	2010/11 Revised Estimate	Change from Strategy	2011/12 Revised Estimate	Change from Strategy
Prudential Indicator – Capital Financing Requirement						
CFR – Non Housing	0	0	0	0	0	0
Net movement in CFR	0	0	0	0	0	0
Prudential Indicator – External Debt / the Operational Boundary						
Borrowing	5,100	0	5,100	0	5,100	0
Other long term liabilities						
Total Debt 31 March	5,100	0	5,100	0	5,100	0

Limits to Borrowing Activity

The first key control over the treasury activity is a PI 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 2008/09 and next two financial years. This allows some flexibility for limited early borrowing for future years.

	2009/10 Revised Estimate	Change from Strategy	2010/11 Revised Estimate	Change from Strategy	2011/12 Revised Estimate	Change from Strategy
Gross Borrowing	5,000	0	5,000	0	5,000	0
Less Investments	(21,357)	0	(19,022)	0	(18,832)	0
Net Borrowing	(16,357	0	(14,022)	0	(13,832)	0
CFR	0	0	0	0	0	0

The Head of Finance and MIS Finance reports that no difficulties are envisaged for the current or future years.

A further PI 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	2009/10 Revised Estimate	Change from Strategy	2010/11 Revised Estimate	Change from Strategy	2011/12 Revised Estimate	Change from Strategy
Borrowing	9,000	0	9,000	0	9,000	0
Other long term liabilities						
Total	9,000	0	9,000	0	9,000	0

* Borrowing Rates

Treasury Strategy 2009/10 – 2011/12

Debt Activity during 2009/10

Future Borrowing and Debt Rescheduling

The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

Long-term fixed interest rates are currently low but expected to rise over the three year planning period. The Bank Rate is expected to remain at 0.5% until mid 2010, before rising gradually.

The Authority is not expected to need any new borrowing in the foreseeable future. If borrowing does become needed the Head of Finance and MIS, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above. The current key difficulty is that future borrowing will increase cash holding at a time when counterparty risk remains high and investment returns are low. In this scenario borrowing is likely to be postponed until cash flow need is more apparent. The expected borrowing need is set out below:

	2009/10 Revised Estimate	**Change from Strategy**	**2010/11 Revised Estimate**	**Change from Strategy**	**2011/12 Revised Estimate**	**Change from Strategy**
Borrowed at 30/09/09	5,100	0	5,100	0	5,100	0
Expected need	0	0	0	0	0	0
Total Borrowing	5,100	0	5,100	0	5,100	0

Opportunities for debt restructuring or repayment is continually monitored. Action will be taken when the Head of Finance and MIS feels it is most advantageous.

INVESTMENTS AS AT 30th SEPTEMBER 2009

As at 31st March 2009 the Council held investments totaling £24,500,000, ranging from call accounts to loans with maturity dates up to 26th January 2010, with the following institutions:

Britannia Building Society
Chelsea Building Society
Coventry
Nationwide
Natwest
Newcastle Building Society
Norwich and Peterborough Building Society
RBS MMF
Skipton Building Society
Yorkshire Building Society