COUNCIL – 9TH JANUARY 2011

Report of the Cabinet

ITEM 6.2 TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MRP POLICY – MID-YEAR REVIEW FOR THE 6 MONTHS TO 30 SEPTEMBER 2011

Purpose of Report

To note the review of the Treasury Management Strategy and the Annual Investment Strategy, plus the various Prudential Borrowing and Treasury Indicators for the first six months of the 2011/12.

Recommendation

That the mid-year review of the Treasury Management Strategy Statement, Prudential Borrowing and Treasury Indicators plus the Annual Investment Strategy, as shown in Part B of the report of Cabinet, be noted.

Reason

To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the Revised CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement, and that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

The Treasury Management Strategy Statement, Prudential & Treasury Indicators and Annual Investment Strategy must be approved by Council each year and reviewed half yearly. This review is set out in the attached Annex. The Strategy for the year was approved by Council on 11 April 2011.

At its meeting on 22nd December 2011, Cabinet considered a report of the Head of Finance and Property Services concerning a review of the Treasury Management Strategy and the Annual Investment Strategy, plus the various Prudential Borrowing and Treasury Indicators for the first six months of the 2011/12 (Minute 81, 2011/2012). The report is attached as an Annex.

The Cabinet resolved that it be recommended to Council that the mid-year review of the Treasury Management Strategy Statement, Prudential Borrowing and Treasury Indicators plus the Annual Investment Strategy, as shown in Part B of the report of Cabinet, be noted.

The reason for the Cabinet's recommendation was to ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the Revised CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement, and that funding of capital expenditure is taken within the totality of the

Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Implementation Timetable including Future Decisions

This report is a review and therefore does not include any future decisions.

Report Implications

The following implications have been identified for this report.

Financial Implications

There are no further financial implications associated with these recommendations.

Risk Management

There are no specific risks associated with these recommendations.

Key Decision:	No
Background Papers:	No additional background papers.
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CABINET – 22nd December 2011 **ANNEX**

Report of the Head of Finance & Property

Lead Member: Councillor T Barkley

Part A

ITEM 11 **Treasury Management Strategy, Annual Investment Strategy and MRP Policy – Mid-Year Review for the 6 Months to 30 September 2011**

Purpose of Report

This report reviews the Treasury Management Strategy and the Annual Investment Strategy, plus the various Prudential Borrowing and Treasury Indicators for the first six months of the 2011/12. In addition, it includes a recommendation to Council to note the review.

Recommendation

That it be recommended to Council to note this mid-year review of the Treasury Management Strategy Statement, Prudential Borrowing and Treasury Indicators plus the Annual Investment Strategy as shown in Part B.

Reason

To ensure that the Council's governance and management procedures for Treasury Management reflect best practice and comply with the Revised CIPFA Treasury Management in the Public Services Code of Practice, Guidance Notes and Treasury Management Policy Statement, and that funding of capital expenditure is taken within the totality of the Council's financial position and that borrowing and investment is only carried out with proper regard to the Prudential Code for Capital Finance in Local Authorities.

Policy Justification and Previous Decisions

The Treasury Management Strategy Statement, Prudential & Treasury Indicators and Annual Investment Strategy must be approved by Council each year and reviewed half yearly. This review is set out in the attached report as Part B. The Strategy for the year was approved by Council on 11 April 2011.

Implementation Timetable including Future Decisions and Scrutiny

This report is a review and therefore does not include any future decisions. It will be available for Overview Scrutiny Group on 19 December 2011 should they wish to consider it.

Report Implications

The following implications have been identified for this report.

Financial Implications

There are no direct financial implications arising from this report.

Risk Management

There are no direct risks associated with the decision Cabinet is asked to make. However, risks associated with the Treasury Policy etc in general are included in Part B.

Key Decision:	No
Background Papers:	CIPFA Code for Treasury Management in the Public Services and Cross –Sectorial Guidance Notes
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Part B

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 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 any borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations.

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. "

2 Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by the Council on 26 April 2010.

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 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 2011/12;
- 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 2011/12;
- A review of the Council's borrowing strategy for 2011/12;
- A review of compliance with Treasury and Prudential Limits for 2011/12.

There are no key changes to the Treasury and Capital Strategies.

3 Economic update

3.1 Global economy

The Euro zone sovereign debt crisis continued with Spain, and particularly Italy, being the focus of renewed market concerns that they may soon join with Greece, Ireland and Portugal in needing assistance. This uncertainty and the lack of a co-ordinated or credible Euro zone response, left commentators concerned over the potential impact of sovereign default and resulting effect on the Euro zone banking sector. The approval by various countries of the £440bn bail out fund in September brought temporary relief to financial markets and the latest proposals in early December are still being evaluated by the markets.

This, coupled with political difficulties in the US over their plans to address the budget deficit, the size and control over the US sovereign debt, and the subsequent loss of the AAA credit rating from Standard and Poors, has led to a much more difficult and uncertain outlook for the world economy. Growth prospects in the US, UK and the Euro zone have been lower than expected, with future prospects similarly cut. Whilst not a central view, concerns of a double dip recession in some Western countries have increased. World stock markets fell in the second quarter of 2011/12 as a consequence.

3.2 UK economy

Following zero growth in the final half of 2010/11 the UK economy grew by a weaker than expected 0.2% in the first quarter of 2011/12, providing a knock on effect to future growth prospects. Growth prospects will be governed by UK consumer sentiment, which is currently subdued due to falling disposable income. Higher VAT, overhanging debt, high inflation and concerns over employment are likely to weigh heavily on consumers into the future.

Inflation remains stubbornly high, although the expectation of future falls, the external nature of the price increases (energy, oil, food etc.), and the negative impact a rate rise would have on the UK economy, is likely to stop the Monetary Policy Committee from raising the Bank Rate for some considerable time to come. International investors continue to view UK government gilts as being a safe haven from the EU sovereign debt crisis. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and sent PWLB borrowing rates to low levels.

3.3 Outlook for the remainder of 2011/12

There remain huge uncertainties in economic forecasts due to the following major difficulties:

- the speed of economic recovery in the UK, US and EU;
- the likely political gridlock in the US preventing significant government fiscal action to boost growth ahead of the Presidential elections in November 2012
- the degree to which government austerity programmes will dampen economic growth;
- the potential for more quantitative easing, and the timing of this in both the UK and US
- the speed of recovery of banks' profitability and balance sheet imbalances

The overall balance of risks is weighted to the downside:

- Sector expect low and modest growth in the UK to continue, with a low Bank Rate to continue for at least 12 months, coupled with an extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to 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, postponing any increases until 2012.

3.4 Sector's interest rate forecast

Sector's Interest Rate View													
	Now	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
Sector's Bank Rate View	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.25%	2.50%
3 Month LIBID	**0.82%**	0.70%	0.70%	0.70%	0.70%	0.70%	0.90%	1.10%	1.30%	1.60%	1.90%	2.40%	2.70%
6 Month LIBID	**1.10%**	1.00%	1.00%	1.00%	1.20%	1.30%	1.50%	1.70%	1.90%	2.10%	2.40%	2.70%	3.00%
12 Month LIBID	**1.59%**	1.50%	1.50%	1.50%	1.60%	1.80%	2.00%	2.25%	2.50%	2.75%	3.00%	3.40%	3.70%
5yr PWLB Rate	**2.44%**	2.50%	2.70%	2.90%	3.00%	3.10%	3.20%	3.40%	3.60%	3.80%	4.00%	4.10%	4.20%
10yr PWLB Rate	**3.52%**	3.80%	4.00%	4.10%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%
25yr PWLB Rate	**4.56%**	5.00%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%	5.30%	5.40%	5.40%	5.50%	5.50%
50yr PWLB Rate	**4.73%**	5.00%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%	5.30%	5.40%	5.40%	5.50%	5.50%

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2011/12 was approved by Council on 11 April 2011. There are no policy changes to the TMSS, the details in this report update the position in the light of the updated economic position. However, the Council will be required to make a one off payment to the CLG to remove the HRA from the current housing subsidy system. The payment is expected to be £79.8m. This one off payment is compensation, ensuring the HRA will no longer make future annual payments to the CLG. It is expected that the overall impact will be beneficial to the Council.

Changes to the TMSS to cover this will be brought to Cabinet in January 2012 and Council on 27 February 2012. Therefore, the various indicators have not been altered for this report.

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;
- Compliance with the limits in place for borrowing activity.

5.1 HRA Reform

The proposed reform of the HRA subsidy arrangements are expected to take place on 28 March 2012. This will involve the Council paying funds to the CLG which will remove the Council from the HRA subsidy system. The expected payment is £79.8m. This will impact on both the capital structure of the Council (as the HRA Capital Financing Requirement will rise by the size of the CLG payment), and the treasury management service will need to consider the funding implications for the borrowing. The Council's prudential indicators shown below highlight the position in relation to the original position, and will need revision in advance of the 28 March 2012. The new HRA Capital Financing Requirement will form a cap on any future HRA capital expenditure.

5.2 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.

Capital Expenditure by Service	**2011/12 Original Estimate £m**	**Current Position £m**	**2011/12 Revised Estimate £m**
Non-HRA	7.43	6.67	6.67
HRA	7.06	7.63	7.63
Total	14.49	14.30	14.30

5.3 Changes to the Financing of the Capital Programme

There have been no material changes to the funding of the Capital programme.

5.4 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.

	2011/12 Original Estimate £m	Current Position £m	2011/12 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement			
CFR – non housing	-2,949	-2,949	-2,949
CFR – housing	-570	-570	-570
Total CFR	-3,519	-3,519	-3,519
Net movement in CFR	**0**	**0**	**0**
Prudential Indicator – External Debt			
Borrowing	2,620	2,000	2,000
Total net debt at 31 March	**-899**	**-1,519**	**-1,519**

5.5 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 2011/12 and next two financial years. This allows some flexibility for limited early borrowing for future years. As can be seen from the above table Charnwood Borough Council currently has a negative borrowing requirement.

	2011/12 Original Estimate £m	Current Position £m	2011/12 Revised Estimate £m
Gross borrowing	2,620	2,000	2,000
Less investments	-20,000	-24,065	-20,000
Net borrowing	-17,380	-22,065	-18,000
CFR (year end position)	-3,519	-3,519	-3,519

The Head of Finance 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. This is currently set at £8.0m and has not changed during the year.

6 Investment Portfolio 2011/12

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. The continuing Euro zone sovereign debt crisis, and its potential impact on banks, prompts a low

risk and short term strategy. Given this risk adverse environment, investment returns are likely to remain low.

The Council held £24m of investments as at 30 September 2011 (£16.8m at 31 March 2011) and the in-house investment portfolio yield for the first six months of the year is 1.30% and the external fund managers 1.01%, both against a benchmark of '7 Day LIBID' of 0.47%.

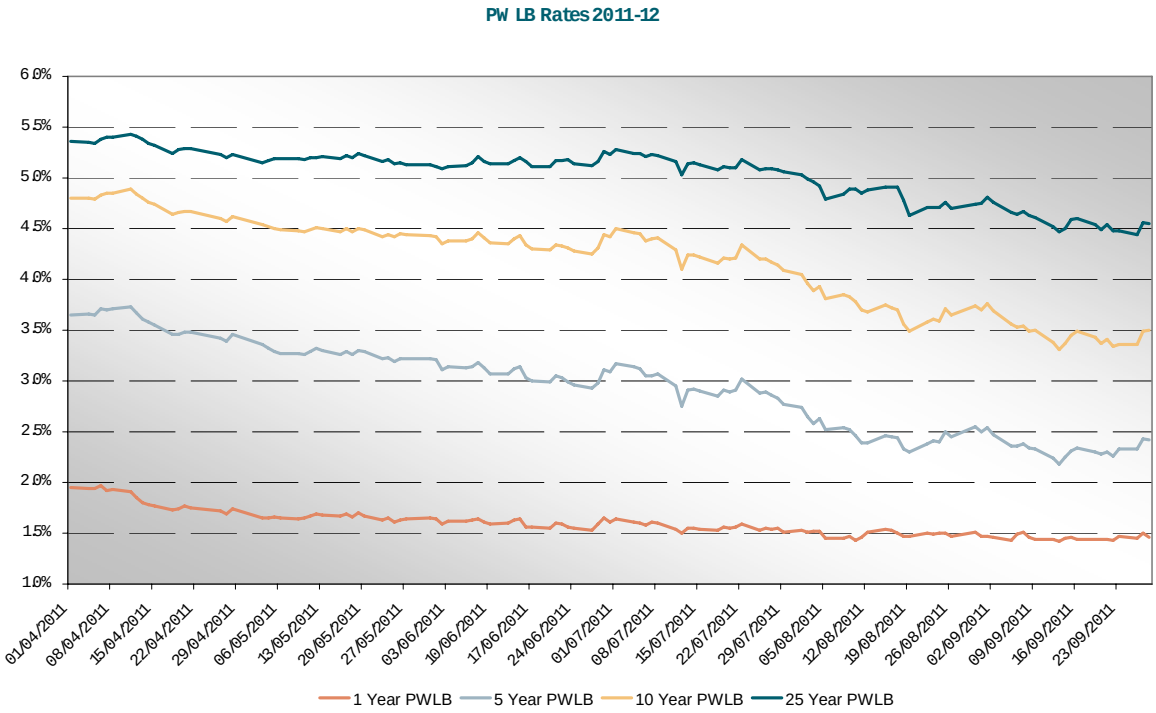
The approved limits within the Annual Investment Strategy were not breached during the first six months of 2011/12. The Council's budgeted investment return for 2011/12 is £200k, and performance for the year to date is £86k above budget at the half year stage.

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function but the number of available institutions has reduced further since 1 April 2011.

7 Borrowing

The Council's capital financing requirement (CFR) – excluding HRA Reform for 2011/12 is a negative £3.5m and as such the council has no need to borrow at present.

The Council is currently analysing the options for the implications of the HRA reform impact as the CLG will require payment on the 28 March 2012 of £79.8m. Loans will be used to pay this amount to ensure the overall position of the Council is safeguarded and the HRA and non-HRA are not disadvantaged. The overall



structure and appropriateness of the resulting portfolio is being considered.

The graph and table above show the movement in PWLB rates for the first six months of the year and provide benchmarking data showing high and low points etc. No debt rescheduling was undertaken during the first six months of 2011/12.

8 Other

As at 22 November 2011 the Council had received £670k from the administrators of Heritable Bank Plc. This represents 65% of the total amount owed and so far payments have been received earlier than originally forecast.

We expect another interim payment in January 2012 but the level of this has not yet been disclosed. The administrator has raised the range of his expected final settlement which is now between 86p and 90p in the pound, up from a maximum of 85p in the pound.

9. Risk Assessment

Risk Identified	Likelihood	Impact	Risk Management Actions Planned
Poor investment decisions due to no strategy in place	Low	High	Approved strategy in accordance with CIPFA guidelines and best practice
Loss of council funds through failure of borrowers	Low	High	Credit ratings and other sources used to minimise risks
Market changes rapidly during year	Medium	Medium	Although strategy in place, the current and future position is monitored through the use of Treasury Consultants and via other sources to provide latest advice.
Failure to take effects of Capital Expenditure when approved into the budgetary process.	Low	High	Robust procedures to approve Capital Plan after all effects have been considered and evaluated by officers and members.
Exposure to interest rates moving adversely without notice	Low	Medium	Treasury Consultants engaged to advise of changing interest rate scenarios affecting the Council.