COUNCIL – 14TH JANUARY 2013

Report of the Cabinet

ITEM 7.2 TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MRP POLICY – MID-YEAR REVIEW FOR THE 6 MONTHS TO 30 SEPTEMBER 2012

Purpose of Report

To present the Treasury Management Strategy and the Annual Investment Strategy, plus the various Prudential Borrowing and Treasury Indicators for the first six months of the 2012/13 to note the review.

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 Cabinet report (attached as an Annex), 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 was taken within the totality of the Council's financial position and that borrowing and investment would only be 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 and 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 Cabinet report (Annex) as Part B. The Strategy for the year was approved by Council on 27th February 2012.

At its meeting on 22nd November 2012, Cabinet considered a report of the Head of Finance and Property Services reviewing the Treasury Management Strategy and the Annual Investment Strategy, plus the various Prudential Borrowing and Treasury Indicators for the first six months of the 2012/13, which is attached as an Annex.

The Cabinet resolved to recommend to Council that the mid-year review be noted (see full recommendation above). Cabinet's reason for this recommendation is set out in the Reasons section above.

Implementation Timetable including Future Decisions and Scrutiny

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

Report Implications

Financial Implications

There are no financial implications associated with the recommendations of the Cabinet further to those detailed in the report of the Head of Finance and Property Services, attached as Annex.

Risk Management

There are no risks associated with the recommendations of the Cabinet further to those detailed in the report of the Head of Finance and Property Services, attached as Annex.

Key Decision:	No
Background Papers:	No additional background papers.
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ANNEX

CABINET – 22 November 2012

Report of the Head of Finance & Property Services

Lead Member: Councillor T Barkley

Part A

ITEM 7 TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MRP POLICY – MID-YEAR REVIEW FOR THE 6 MONTHS TO 30 SEPTEMBER 2012

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 2012/13. 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 27 February 2012.

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 9 November 2012, should they wish to consider it, and for the Audit Committee on 4 December 2012

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: None

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Part B

1 Treasury Management Update - Half Year Ended 30 September 2012

The CIPFA (the Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that Members be updated on treasury management activities regularly. This report therefore ensures this council is implementing best practice in accordance with the Code.

2 Summary Economic Outlook

This section does not cover the last six months' economic outcomes as these have been adequately covered in the media.

3 Eurozone

4 A new storm is brewing as Greece, yet again, is failing to meet the demands of the austerity programme in cutting government expenditure, increasing tax revenue and selling off public sector assets. German patience with this situation must be close to breaking point and without German support Greece will run out of cash within the next couple of months. Markets are currently predicting an end game where Greece is eventually forced to exit the Eurozone and return to the drachma.

5 More worryingly, sovereign bond yields for both Spain and Italy rose sharply to levels previously deemed unsustainable. Spain is now actively looking at what might be acceptable terms for receiving a bailout and surrendering national sovereignty to external oversight by the IMF and Eurozone paymasters.

6 One possible, but very unlikely, solution to the Eurozone debt crisis would be the issue of Eurobonds. These would collectivise all debt in the Eurozone and reduce the Greek element in total Eurozone debt to an almost insignificant percentage.

7 Austerity programmes in various countries are reducing GDP growth rates.

8 USA

9 Gross Domestic Product (GDP) is weakening alongside the recovery in jobs growth. The Federal Reserve predicts that current ultra-low interest rates may be warranted until at least mid-2015.

10 There is political gridlock ahead of the November 2012 Presidential elections, for major fiscal action. The new President is unlikely to make a significant fiscal impact on the US economy in 2013 as the unsustainably high budget deficit will need to be urgently addressed.

11 The housing market is at last beginning to show tentative signs of picking up. Confidence figures among US consumers rose to a seven month high in September as the Conference Board's index of optimism rose from 61.3 to 70.3.

12 China

13 There are increasing concerns that efforts to stimulate the economy could fail to avoid a hard landing. There are now many parts of the economy flashing distress signals. A fresh round of support is widely expected. This could coincide with the change in the party hierarchy which is due to take place at the 18th Party Congress which begins in early November.

14 UK

15 The UK has suffered its worst and slowest recovery from recession of any of the five recessions since 1930. The Bank of England August 2012 Inflation Report again pushed back the timing of a return to trend growth and the rate at which inflation will fall back towards the target rate of 2%.

16 40% of UK GDP is dependent on overseas trade; high correlation of UK growth to US and EU GDP growth means that the UK economy is likely to register weak growth in the next two years.

17 Consumers are likely to remain focused on paying down debt; weak consumer sentiment and job fears will all act to keep consumer expenditure suppressed. It is likely to take a lot longer to eliminate the structural budget deficit than in the current plans of the Coalition government. These plans will need to be updated to incorporate the impact of weak growth in the Eurozone and US depressing UK GDP growth, and thus lower expectations for increases in tax revenues.

18 The Coalition Government and the Bank of England have put in place a programme of action to improve the availability of credit in the economy. However, it will take time for this to feed through into a significant positive impact on GDP growth in the economy. There is little sign of a coordinated strategy for the private sector to finance a major expansion of infrastructure investment to boost UK growth.

19 Eurozone concerns and the potential for further QE to stimulate GDP growth are likely to keep gilt yields depressed during the next twelve months. UK gilts are likely to retain safe haven status from Eurozone worries for some time. Eurozone politicians struggle to reach agreement on how to replace impressive sounding words with actually implementing an effective platform of measures to conclusively subdue the debt crisis

20 However, there are improvements in the prospects for the UK economy, though there is still a long way to go.

- UK banks have made huge progress since 2008 in correcting their over-extended balance sheets, though credit availability still remains weak.

- Consumers have also made progress in correcting their personal over-borrowed balance sheets so that personal debt relative to incomes is now down to the lowest level since 2004. However, at 146%, it still remains the highest of any G7 nation.

- The car industry is well on track to increase production. This is expected to see an increase from about 1m cars per annum in 2009 to 2.25m by 2016, much of which will be exported. In addition, car component firms are moving production to the UK in order to cost effectively meet the consequent increase in demand for their products. The car industry has also made steady progress in reducing its labour costs to be below those of Germany, France, Italy and even Spain.

- The fall in price inflation relative to increases in pay inflation meant that household disposable income was less affected in the three months to June 2012, the biggest improvement in three years.

- Recent increases in employment also strengthen consumer expenditure, tax receipts and reduce Government expenditure on benefits.

- The UK is less encumbered to hindrances to new investment and new employment than countries in the Eurozone and has a competitive currency.

- The UK has a more effective approach to stimulating growth than in the Eurozone in the areas of monetary policy and direct action to improve the supply of liquidity to the real economy

21 The Council's Treasury adviser's (Sector) forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Key areas of uncertainty include:

- The impact of the Eurozone crisis on financial markets and the banking sector;

- The impact of the UK Government's austerity plan on confidence and growth;

- Monetary policy action failing to stimulate growth in western economies;

- The potential for weak growth or recession in the UK's main trading partners - the EU and US;

22 The overall balance of risks remains weighted to the downside. Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries. However, near-term, QE is likely to depress yields and further QE thereafter may lead to a reassessment of Sector's central forecast

23 Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before early 2014 as very limited indeed. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

24 Interest rate forecast

The Council's treasury advisor, Sector, provides the following forecast:

	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%	0.75%	1.00%
5yr PWLB rate	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.30%
10yr PWLB rate	2.50%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.20%	3.30%
25yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%
50yr PWLB rate	3.90%	3.90%	3.90%	4.00%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%

Sector undertook a review of its interest rate forecasts following the issue of the Bank of England Inflation Report for August 2012. Consequently, it pushed back the first rise in Bank Rate from early to late 2014, as well as lowering the pace of rises in gilt yields.

25 The Bank of England forecasts of the speed and strength of recovery and rate of reduction of CPI inflation over the last four years had been attracting increasing criticism for being consistently over optimistic. In this latest Inflation Report, the Bank changed its position significantly in as much as it markedly downgraded its forecasts for the strength and speed of recovery in GDP growth. Whereas previously it had consistently been forecasting a strong recovery to over 3% p.a., it was now only forecasting growth to recover to around 2% during the period from early 2013 to the end of 2015.

26 Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2012/13, which includes the Annual Investment Strategy, was approved by the Council on 27 February 2012. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

27 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 and the heightened credit concerns it is considered appropriate to keep investments short term with a maximum duration of 3 months.

This limit will apply to all entities on the suggested Sector Credit List with the following exceptions:

1. UK Government and related entities such as Local Authorities. Their suggested duration limit will remain at 5 years.
2. UK semi-nationalised institutions (Lloyds / RBS). Sector continue to view the current significant UK ownership of these entities as providing significant comfort to investors.
3. Money Market Funds.

28 A full list of investments held as at 30 September 2012 are shown in Appendix 2 and officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the six months ended 30 September 2012.

29 Investment rates available in the market have continued at historically low levels. The average level of funds available for investment purposes during the half year was £12.36m. These funds were mainly available on a temporary basis, and the level of funds available was primarily dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.

30 Investment performance for six months ended 30 September 2012

Benchmark	Benchmark Return	Council In-House Performance	Investment Interest Earned	Investec Performance	Investment Interest Earned	Total Interest Earned
	%	%	£'000	%	£'000	£'000
7 day LIBID	0.40%	1.37%	80	1.24%	35	115

As illustrated, the Council's in-house investments outperformed the benchmark by 0.97%. This is primarily due to one £5m investment at a rate of 2.15% for five months of the period. The Council's external fund managers, Investec, also beat the benchmark by 0.84% which resulted in total investment income of £115k for the six months compared to a budget of £115k, so the Council is on track to achieve its investment income budget of £230k for the year, despite there being no increase in overall interest rates. (The benchmark and performance percentage figures are all on an annualised basis).

31 New borrowing:

No new borrowing was undertaken during the six months to 30 September 2012.

32 Borrowing in advance of need.

This Council has not borrowed in advance of need during the six months ended 30 September 2012.

32 Debt Rescheduling

No debt rescheduling was undertaken during the six months.

33 Compliance with Treasury and Prudential Limits

It is a statutory duty of the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved Treasury Management Strategy Statement (TMSS).

During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in appendix 1.

34 Other

This Council originally had £1m invested with the Heritable Bank Plc, which is a subsidiary of Landsbanki, one of the failed Icelandic banks. At the current time, the process of recovering assets is still ongoing with the administrators. In the case of Heritable Bank plc, the administrators have made a number of dividend payments to date, with further payments and updates anticipated during 2012/13. As at 30 September 2012 £774k had been received from the administrators and an overall recovery amount of between 86p and 90p in the pound is still predicted by the administrators.

APPENDIX 1: Prudential and Treasury Indicators as at 30 September 2012

Treasury Indicators	2012/13 Budget £'000	30/9/12 Actual £'000
Authorised limit for external debt	96,690	81,190
Operational boundary for external debt	87,190	81,190
Gross external debt	83,332	81,190
Investments	16,800	21,536
Net borrowing	66,532	59,654
Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	0	0
12 months to 2 years	0	0
2 years to 5 years	0	0
5 years to 10 years	0	0
10 years and above	100%	100%
Upper limit of fixed interest rates based on net debt	100%	96.6%
Upper limit of variable interest rates based on net debt	90%	3.4%
Upper limit for principal sums invested for over 364 days	29.8%	3.4%

Prudential Indicators	2012/13 Budget £'000	30/9/12 Actual £'000
Capital expenditure – General Fund	1,690	554
Capital expenditure - HRA	13,036	7,815
Capital Financing Requirement (CFR) - GF	-1,845	-1,845
Capital Financing Requirement (CFR) - HRA	80,761	80,761
Annual change in CFR - GF	232	232
Annual change in CFR - HRA	2,141	2,141
In year borrowing requirement	2,373	0
Ratio of financing costs to net revenue stream - GF	0	0
Ratio of financing costs to net revenue stream - HRA	15.51	15.51
Incremental impact of capital investment decisions:-		
a) Increase in council tax (band change) per annum.	-1.39	-1.39
b) Increase in average housing rent per week (housing authorities only).	0	0

APPENDIX 2: Investment portfolio

Investments held as at 30 September 2012.

Institution	Maturity Date	Interest Rate %	Principal £'000
Bank of Scotland	02/09/2013	2.85%	6,000
Money Market Funds	I day	0.61%	5,849
Investec	Various	N/A	9,687
Total			**21,536**