REPORT FOR DECISION

Agenda Item	

DECISION OF:	**EXECUTIVE** **SCRUTINY COMMITTEE (INTERNAL)** **COUNCIL**
DATE:	**12 OCTOBER 2011** **25 OCTOBER 2011** **26 OCTOBER 2011**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY – MID YEAR REVIEW 2011/12**
REPORT FROM:	**DEPUTY LEADER AND EXECUTIVE MEMBER FOR FINANCE**
CONTACT OFFICER:	**MIKE OWEN, EXECUTIVE DIRECTOR OF RESOURCES** **STEPHEN KENYON, ASSISTANT DIRECTOR OF RESOURCES (FINANCE AND EFFICIENCY)**
TYPE OF DECISION:	**COUNCIL**
FREEDOM OF INFORMATION/STATUS:	The report is for publication
SUMMARY:	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 for 2011/12 • A review of the Council's borrowing strategy for 2011/12 • A review of any debt rescheduling undertaken during 2011/12 • A review of compliance with Treasury and Prudential Limits for 2011/12

OPTIONS & RECOMMENDED OPTION	It is recommended that the Scrutiny Committee notes the report; It is recommended that Executive approves, for onward submission to Council, the: • The mid year review of the Treasury Management Strategy for 2011/12 • The expected impact on the capital and treasury plans of the Housing Revenue Account reform measures; It is recommended that Council approves the report. Reasons for the Decision: It is a requirement of the CIPFA Code that the Council receives a mid-year report on the Treasury Management Strategy. The report shows that Treasury Management activities to 30 September 2011 were in line with the Annual Strategy.

IMPLICATIONS:	
Corporate Aims/Policy Framework:	Do the proposals accord with the Policy Framework? Yes
Statement by the S151 Officer: Financial Implications and Risk Considerations:	Treasury Management is an integral part of the Council's financial framework and it is essential that the correct strategy is adopted in order to ensure that best value is obtained from the Council's resources and that assets are safeguarded.
Statement by Executive Director of Resources:	There are no additional resource implications. Despite the fact that the Treasury Management budget was reduced by £0.2m in 2011/12 to assist with the savings required to balance the overall revenue budget Treasury management activities so far have produced a projected underspending for the year of £0.451m. This will help to support other areas of the Council's budget that are under pressure from user demand or economic conditions.
Equality/Diversity implications:	No
Considered by Monitoring Officer:	Yes

Wards Affected:	All
Scrutiny Interest:	Scrutiny Committee (Internal)

TRACKING/PROCESS **DIRECTOR:** Mike Owen

Chief Executive/ Strategic Leadership Team	Executive Member/Chair	Ward Members	Partners
Yes	Yes	N/a	N/a
Scrutiny Committee	Committee	Council	
Internal	Executive	**Yes**	

1.0 BACKGROUND

1.1 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".

1.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 24 February 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: Scrutiny Committee (Internal).

1.3 This report fulfils the requirement to produce a mid-year review.

2.0 ECONOMIC UP-DATE

2.1 **Global economy**

2.1.1 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 perceived 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.

2.1.2 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.

2.1.3 Growth prospect in the US, UK and the Euro zone have been lower than expected, with future prospects similarly cut. World stock markets fell in the second quarter of 2011/12 as a consequence.

2.2 **UK economy**

2.2.1 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 sentiments, which are 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.

2.2.2 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 time to come.

2.2.3 International investors continue to view UK government gilts as being a safe haven, bolstered by both the EU sovereign debt concerns and the US difficulties. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and sent PWLB borrowing rates to low levels.

2.3 Outlook for the next six months of 2011/12:

2.3.1 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 potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy;
- 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 positions

2.3.2 The overall balance of risks to the economic outlook is weighted to the downside:

- Growth in the UK economy is expected to be low in the medium term with the historically low Bank Rate to continue for at least 12 months. This will have a subduing effect on investment returns;
- 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.

2.3.3 The key issue for the treasury management strategy arising from the economic outlook is the potential impact on interest rates and the table below summarises 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	0.75%	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	1.04%	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	1.51%	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	2.50%	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	3.71%	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	4.76%	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	4.81%	5.00%	5.00%	5.10%	5.10%	5.10%	5.20%	5.20%	5.30%	5.40%	5.40%	5.50%	5.50%

3.0 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UP-DATE

3.1 The Treasury Management Strategy Statement (TMSS) for 2011/12 was approved by the Council on 23 February 2011. Since then there have been no policy changes to the TMSS and so this report focuses on up-dating the position in the light of the latest economic position and the budgetary changes already approved.

3.2 Investment Strategy

3.2.1 The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as being:

- Security of capital
- Liquidity

3.2.2 The Strategy also made clear that the Council will aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (maximum loan period of 12 months), and only invest with highly credit rated financial institutions, using Sector's suggested creditworthiness approach, including sovereign credit rating and credit default swap (CDS) overlay information provided by Sector.

3.2.3 The mid-year review has confirmed that all investments were made in line with Sector's suggested credit worthiness matrices and the approved limits within the Annual Investment Strategy were not breached during quarters 1 and 2 of 2011/12. At 30 September 2011 the Council's investments totalled £47.5 million and comprised:-

Type of Investment	£ Million
Call Investments (Cash equivalents)	11.5
Fixed Investments (Short term investments)	36.0
Total	**47.5**

3.2.4 As outlined in the economic background section above, investment rates available in the market are at a historical low point. The average level of funds available for investment purposes in the first six months of 2011/12 was £43.4m. 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.

3.2.5 Investments have also been used (in place of more expensive borrowing) to fund schemes such as the Townside Fields development.

3.2.6 The Council earned a return of **1.36%** on investments in the first half of 2011/12 which is significantly higher than Sector's benchmark return of 0.90% for the year. As a result of this better than average return the Council is forecast to underspend on the treasury management budget by £0.451m in the current year.

3.3 Borrowing Strategy

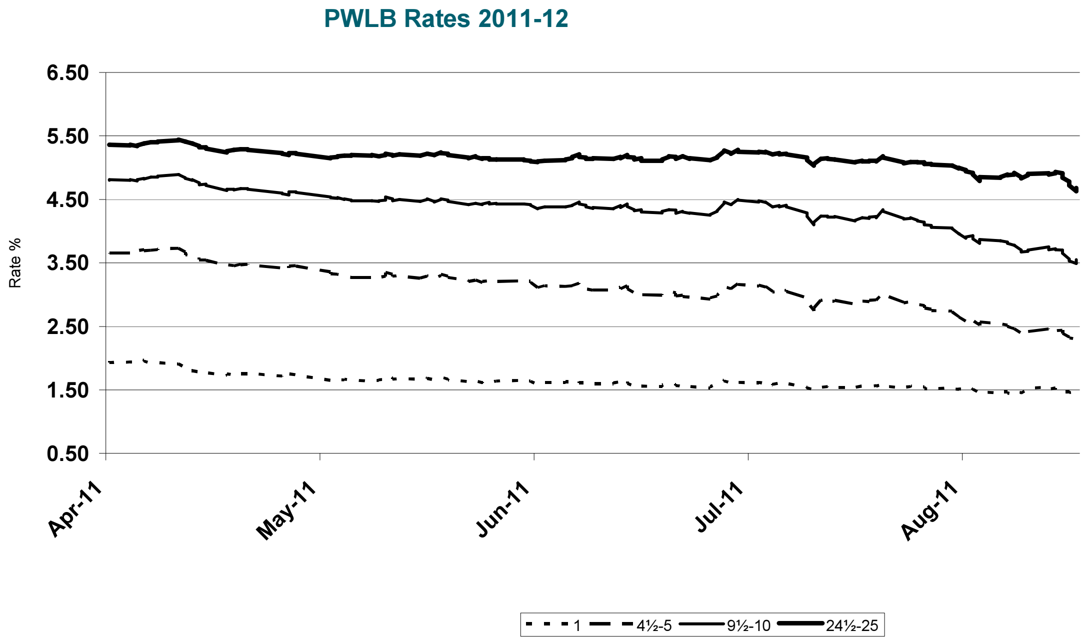
3.3.1 The Council's capital financing requirement (CFR) at 1st April 2011 was £171.7m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The CFR should always be above the level of actual borrowing. At 1st April 2011 actual borrowing was £137.8m which means that the Council has internal borrowing of £33.9m. Therefore there is considerable scope for further external borrowing should the Strategy change and indicate that borrowing is required.

3.3.2 The CFR increased by £7.5m in 2010/11 and despite the overall strategy for 2011/12 being to finance capital expenditure by running down cash/investment balances it was decided that short term borrowing would be a more cost efficient way of meeting this liability. The same was true when short-term cash flow shortfalls occurred in August and a very short-term loan of £7m was taken out. The details of this borrowing is shown below:

Lender	Rate	Amount	Start Date	End Date
Portsmouth City Council	0.50%	£5m	24/08/11	24/02/12
Wirral MBC	0.60%	£7m	23/08/11	17/10/11
Total		**£12m**		

3.3.3 Given that investment returns are likely to remain low (say) 0.90% p.a. for the financial year 2011/12, then the strategy of running down investments and taking **temporary** loans rather than taking more expensive long term borrowing will continue. Due to the structure of our investments then it is anticipated that further temporary borrowing may be undertaken during this financial year.

3.3.4 The graph and table below show the movement in PWLB rates for the first five months of the year and provide benchmarking data showing high and low points etc.



4.0 DEBT RESCHEDULING

4.1 Officers constantly examine opportunities for advantageous debt rescheduling opportunities; however due to the current economic climate and consequent structure of interest rates there have been no such opportunities and so no debt rescheduling was undertaken during the first six months of the current year.

5.0 COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS

5.1 It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved TMSS.

5.2 During the financial year to date the Council has operated within all of the treasury limits 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 the appendix.

6.0 HOUSING REVENUE ACCOUNT REFORMS

6.1 The Government has announced plans to reform the system of financing Council housing. Currently Council housing is supported via the housing subsidy system which involves individual Councils either receiving a payment from, or making a payment to, the Government depending on the outcome of a complex calculation based on a 'notional' Housing Revenue Account. Bury makes a significant payment TO the Government under the current system.

6.2 The proposed system, known as 'Self-financing' will put all local authority landlords in the position where they can support their own stock from their own income. In order to bring about this change, there will be a readjustment of each local authority's housing debt. This will give each local authority a level of debt it can support, based on a valuation of its council housing stock. If this valuation is lower than the amount of housing debt which is currently supported through the subsidy system, Government will pay off the difference. If the valuation is higher than the debt supported by Housing Revenue Account subsidy, the local authority will be required to pay Government the difference. Payments from central Government will in most cases not go to local authorities directly, but will be used to redeem debt held with the Public Works Loan Board.

6.3 The new system is being enacted through the Localism Bill that is currently being considered by Parliament and whilst it is envisaged that the system will be in place by 1 April 2012 this very much depends on the Bill being enacted.

6.4 Generally speaking, Council's that make a payment **to** the Government under the current system will see their debt increased to compensate for the reduction in their costs.

6.5 Officers from the Council and Six Town Housing are currently assessing the implications for Bury but initial indications are that we will be required to pay the Department for Communities and Local Government a sum in the order of **£78.6m** (estimated) on 28 March 2012. This will be financed by a mix of loans and available cash resources and the payment needs to be structured in a way that neither the HRA or the General Fund are not disadvantaged.

6.6 A further report will be brought to the Executive in January 2012, once final details of the proposed system are known, setting out the exact implications and seeking approval for a structure of financing the exact payment to the DCLG.

Councillor John Smith
Deputy Leader & Executive Member for Finance

List of Background Papers:-
None

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