REPORT FOR DECISION

Agenda Item	

DECISION OF:	**CABINET** **OVERVIEW & SCRUTINY COMMITTEE** **COUNCIL**
DATE:	**28 NOVEMBER 2012** **5 DECEMBER 2012** **12 DECEMBER 2012**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY – MID YEAR REVIEW 2012/13**
REPORT FROM:	**CABINET MEMBER FOR FINANCE & RESOURCES**
CONTACT OFFICER:	**STEPHEN KENYON, ASSISTANT DIRECTOR OF RESOURCES (FINANCE AND EFFICIENCY)** **ANDREW BALDWIN, HEAD OF FINANCIAL MANAGEMENT**
TYPE OF DECISION:	**COUNCIL**
FREEDOM OF INFORMATION/STATUS:	The report is within the public domain
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 2012/13 • A review of the Treasury Management Strategy Statement and Annual Investment Strategy for 2012/13 • A review of the Council's borrowing strategy for 2012/13 • A review of any debt rescheduling undertaken during 2012/13 • A review of compliance with Treasury and Prudential Limits for 2012/13

OPTIONS & RECOMMENDED OPTION	It is recommended that, in accordance with CIPFA's Code of Practice on Treasury Management, the report be noted.

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 Assistant Director of Resources (Finance and Efficiency):	There are no additional resource implications. Treasury management activities so far have produced a projected underspending for the year of £0.852m. 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:	Overview & Scrutiny Committee

TRACKING/PROCESS **DIRECTOR: STEVE KENYON**

Chief Executive/ Strategic Leadership Team	Cabinet Member/Chair	Ward Members	Partners
	28/11/12	N/a	N/a
Scrutiny Committee		Committee	Council
5/12/12			12/12/12

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: Overview & Scrutiny Committee.

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

2.0 ECONOMIC UP-DATE

2.1 Economic Performance to date

2.1.1 Economic sentiment, in respect of the prospects for the UK economy to recover wiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. It was noted that the UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone, and that on-going negative sentiment in that area would inevitably permeate into the UK's economic performance.

2.1.2 With regard to the Eurozone, investor confidence remains weak because successive "rescue packages" have first raised, and then disappointed, market expectations. However, 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.

2.1.3 In the UK, 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. UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession. This means that the UK's recovery from the initial 2008 recession has been the worst and slowest of any G7 country apart from Italy (G7 = US, Japan, Germany, France, Canada, Italy and UK). It is also the slowest recovery from a recession of any of the five UK recessions since 1930 and total GDP is still 4.5% below its peak in 2008.

2.1.4 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 back further into the future. The Monetary Policy Committee has kept Bank Rate at 0.5% throughout the period while quantitative easing was increased by £50bn to £375bn in July. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

2.1.5 On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested in and gilt yields, prior to the ECB bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

2.2 Outlook for the next six months of 2012/13

2.2.1 The risks in economic forecasts continue unabated from the previous treasury strategy. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown. In America, it is too early to say what impact the recent presidential election will have, but urgent action will be required early in 2013 to address the US debt position. However, on 13 September the Fed. announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid 2015.

2.2.2 Eurozone growth will remain weak as austerity programmes in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it has failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. There is the distinct possibility that some of the northern European countries could push for the ejection of Greece from the Eurozone unless its financial prospects improve, which does not seem likely at this juncture. The Eurozone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous "solutions" to the Eurozone crisis.

2.2.3 The Bank of England Quarterly Inflation Report in August pushed back the timing of the return to trend growth and also lowered its inflation expectations. Nevertheless, concern remains that the Bank's forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world headwinds the UK economy faces. Weak export markets will remain a drag on the economy and consumer expenditure will continue to be depressed due to a focus on paying down debt, negative economic sentiment and job fears. The Coalition Government, meanwhile, is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

2.2.4 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.
- This interest rate forecast 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

The above Sector forecasts for PWLB rates incorporate the introduction of the **PWLB certainty rate** in November 2012 which will reduce PWLB borrowing rates by 0.20% for most local authorities. The actual PWLB rates on 17.9.12 ought therefore to be reduced by 20bps to provide a true comparison to the forecasts.

(Gilt yields have also risen significantly after the recent ECB bond buying policy announcement but Sector feel that yields are likely to fall back after this initial bounce.)

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

3.1 The Treasury Management Strategy Statement (TMSS) for 2012/13 was approved by the Council on 22 February 2012. 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 2012 the Council's investments totalled £39.4 million and comprised:-

Type of Investment		**£ Million**
Call Investments(Cash equivalents)		18.4
(NatWest	£14.8m)	
(Bank of Scotland	£3.6m)	
Fixed Investments (Short term investments)		21.0
(Royal Bank of Scotland	£3.7m)	
(Bank of Scotland	£17.3m)	
Total		**39.4**

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 2012/13 was £31.25m. 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 and the Equal Pay Back Pay settlements.

3.2.6 The Council earned a return of **1.73%** on investments in the first quarter of 2012/13 and **1.76%** in the second quarter. These returns are significantly higher than Sector's benchmark return of (say) 0.90% for the year.

3.3 Borrowing Strategy

3.3.1 The Council's capital financing requirement (CFR) at 1st April 2012 was £248.196m. 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 2012 actual borrowing was £205.621m which means that the Council has internal borrowing of £42.575m. Therefore there is considerable scope for further external borrowing should the Strategy change and indicate that borrowing is required.

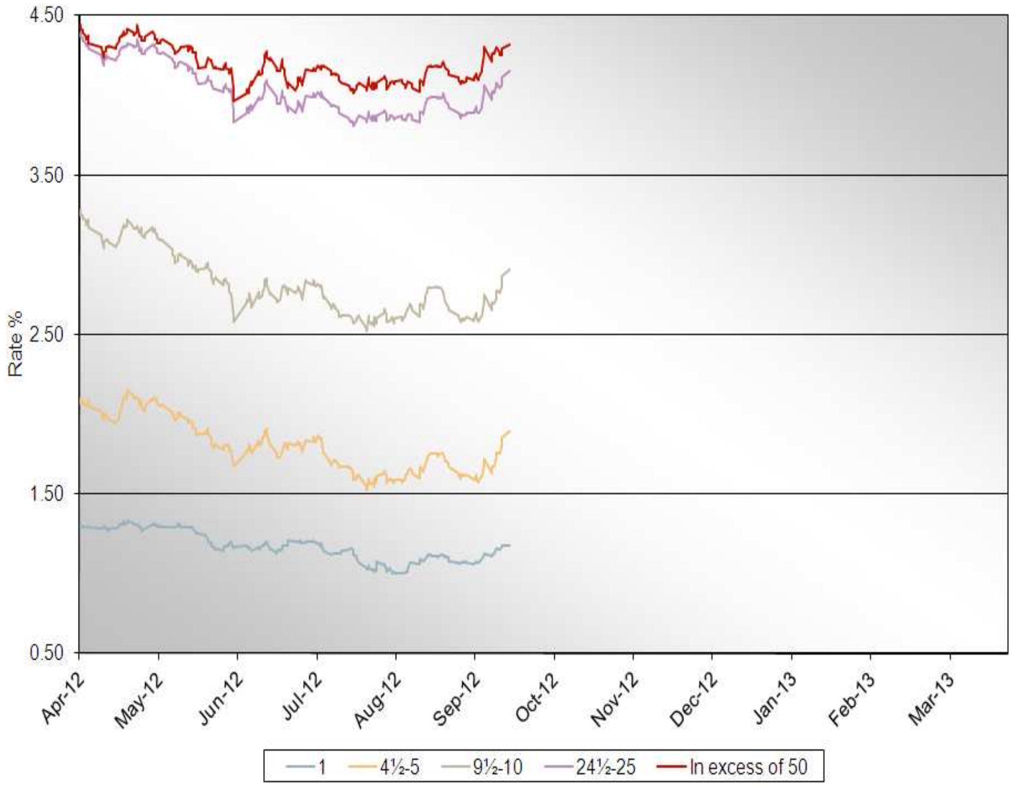
3.3.2 The Council repaid debt of £10m in 2011-12 and has not yet made any replacement loans other than £3m of temporary loans as follows:

Lender	Rate	Amount	Start Date	End Date
Tendring District Council	0.55%	£2m	01/05/12	01/11/12
Humberside Fire Authority	0.30%	£1m	16/07/12	15/07/13
Total		**£3m**		

3.3.3 This activity is in line with the overall strategy for 2012/13 which is to finance capital expenditure by running down cash/investment balances and taking short term temporary borrowing rather than more expensive longer term loans (Note that the current cost of a 5 year PWLB loan is 1.89% - see table at 2.3 above). The taking out of longer term loans (1 to 10 years) will only then be considered if required by the Council's underlying cash flow needs. With the reduction of cash balances the level of short term investments will fall. Given that investment returns are likely to remain low (say) 0.90% p.a. for the financial year 2012/13, then savings will be made by running down investments and taking temporary loans rather than taking more expensive long term borrowing. It is anticipated that further temporary borrowing will be undertaken during this financial year.

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

PWLB Rates 2012-13



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.

Councillor Tony Isherwood
Cabinet Member for Finance and Resources

List of Background Papers:-

None

Contact Details:-

Stephen Kenyon, Assistant Director of Resources, Tel 0161 253 5237
E-mail s.kenyon@bury.gov.uk

Andrew Baldwin, Head of Financial Management, Tel 0161 253 5034
E-mail a.baldwin@bury.gov.uk

APPENDIX Prudential and Treasury Indicators

The following prudential indicators, in the table below, are relevant for the purposes of setting an integrated treasury management strategy.

PRUDENTIAL INDICATOR	**2011/12**	**2012/13**	**2013/14**	**2014/15**	
(1). AFFORDABILITY PRUDENTIAL INDICATORS	**actual**	**estimate**	**estimate**	**Estimate**	
Capital Expenditure	**£'000**	**£'000**	**£'000**	**£'000**	
Non – HRA	21,558	13,646	2,654	1,686	
HRA (applies only to housing authorities)	5,016	6,937	0	0	
Housing Reform Settlement	78,253	0	0	0	
TOTAL	**104,827**	**20,583**	**2,654**	**1,686**	1
Capital Financing Requirement (CFR)	**£'000**	**£'000**	**£'000**	**£'000**	
Non – HRA	129,412	137,442	131,000	124,815	
HRA (applies only to housing authorities)	40,531	40,531	40,531	40,531	
Housing Reform Settlement	78,253	78,253	78,253	78,253	
TOTAL	**248,196**	**256,226**	**249,784**	**243,599**	2
Affordable Borrowing Limit					
Estimate of incremental impact of capital investment decisions	**£**	**£**	**£**	**£**	
Increase in council tax (band D, per annum)	0.00	0.35	2.67	0.00	3
Increase in housing rent per week	0.00	0.0	0.0	0.0	4
Ratio of financing costs to net revenue stream					
Non – HRA	2.32%	2.30%	2.30%	2.25%	5
HRA (applies only to housing authorities)	5.82%	5.70%	5.59%	5.48%	5
Net External Borrowing only to support the CFR in Medium Term		**£'000**			
Net External borrowing over medium term		205,621			
Total CFR over Medium Term		248,196			
Net External Borrowing < Total CFR		TRUE			6

TREASURY INDICATOR	**2011/12**	**2012/13**	**2013/14**	**2014/15**	
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**actual**	**estimate**	**estimate**	**estimate**	
Authorised limit for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	
Borrowing	214,900	214,500	214,500	214,500	
other long term liabilities	7,400	7,100	6,800	6,500	
Housing Reform Settlement	78,253	78,253	78,253	78,253	
TOTAL	300,553	299,853	299,553	299,253	7
Operational boundary for external	**£'000**	**£'000**	**£'000**	**£'000**	

debt -					
Borrowing	189,800	189,400	189,400	189,400	
Other long term liabilities	7,400	7,100	6,800	6,500	
Housing Reform Settlement	78,253	78,253	78,253	78,253	
TOTAL	275,053	274,753	274,453	274,153	7
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	140%	140%	140%	140%	8
Upper limit for variable rate exposure					
Net principal re variable rate borrowing / investments	-40%	-40%	-40%	-40%	8
Upper limit for total principal sums invested for over 364 days	**£'000**	**£'000**	**£'000**	**£'000**	
(per maturity date)	10,000	10,000	10,000	10,000	9

Maturity structure of new fixed rate borrowing during 2012/13	Upper limit	lower limit
Under 12 months	40%	0%
12 months and within 24 months	35%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	50%	0%
10 years and above	90%	30%

Notes to the indicators:

1. Capital expenditure is derived from the Capital Programme forecast. Capital expenditure decreases over the 3 year forecast as further external funding is to be identified.

2. Capital Financing Requirement relates to all capital expenditure – i.e. it includes relevant capital expenditure incurred in previous years. The Capital financing requirement reflects the authority's underlying need to borrow.

3. The finance costs related to the increases in capital expenditure impact upon Council tax.

4. There is no direct impact of capital expenditure on housing rents as the housing rent is set according to Government formula.

5. Both General Fund and HRA finance costs to net revenue streams remain stable throughout the 3 year forecast.

6. To ensure that borrowing is only for a capital purpose and therefore show that the authority is being prudent this indicator compares the level of borrowing and capital financing requirement (CFR) over the medium term. The level of borrowing will always be below the CFR.

7. The authorised limit and operational boundary are consistent with the authority's plans for capital expenditure and financing. The authorised limit is the maximum amount that the authority can borrow. There is headroom

within this limit to borrow the following 3 years capital financing requirement.

8. The variable and fixed limits together look at the whole portfolio and will therefore together always show 100% exposure. Variable interest rate limit can be positive or negative as investments under 364 days are classed as variable and are credit balances which are offset against debit variable loans. The smaller the balance of investments, the more likely the variable limit will be positive as the variable loan debit balance will be higher than the credit investment balance offset against it.

9. Principal sums invested for periods longer than 364 days has been set at £10 million. The investment balance is estimated to be cash flow driven, however if the opportunity arises that surplus investment balances are available then advantage will be taken of favourable rates.