

**AGENDA ITEM NO. 10**

**COUNCIL**

**Date**                    **20 DECEMBER 2012**

**Title**                    **TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW 2012/13**

**1. PURPOSE/SUMMARY**

The purpose of this report is to review the Council’s Treasury Management activity for the first six months of 2012/13.

**2. KEY ISSUES**

- The Treasury Management Mid-Year Review 2012/13 as considered by Cabinet on 20 December 2012 and by Corporate Governance Committee on 4 December 2012 is attached.
- The report highlights all the key activities carried out within the Treasury Management function during the first six months of 2012/13. All activities have been conducted in accordance with the approved strategy and policies.
- The Capital Financing Requirement (CFR) prudential indicator has been revised.
- The TMSS creditworthiness policy has been amended to retain the Council's own bank as an investment counterparty in the event of deterioration in the banks credit rating.
- 2012/13 continues to be a challenging year and the report highlights the success in maximising investment income whilst ensuring the security and liquidity of the Council's investments.

**3. RECOMMENDATION**

**It is recommended that:-**

- (i) Members note the report.

**It is recommended by Cabinet and Corporate Governance Committee that:-**

- (ii) The revised TMSS creditworthiness policy (paragraph 5) and increase in the CFR prudential indicator (paragraph 4) be approved.

**AGENDA ITEM NO.6**

**CORPORATE GOVERNANCE COMMITTEE**

**Date**            **4 DECEMBER 2012**

**Title**            **TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY MID-YEAR REVIEW 2012/13**

**2. PURPOSE/SUMMARY**

The purpose of this report is to review the Council’s Treasury Management activity for the first six months of 2012/13.

**4. KEY ISSUES**

- The Council has operated within its Treasury Management Strategy Statement (TMSS), Annual Investments Strategy and treasury limits and prudential indicators set by Council for the first six months of 2012/13.
- The Capital Financing Requirement (CFR) prudential indicator has been revised.
- The TMSS creditworthiness policy has been amended to retain the Council’s own bank as an investment counterparty in the event of deterioration in the banks credit rating.
- Interest rates have continued at historically low rates throughout this year.
- Investment income received for the first six months of 2012/13 is £170,000 (£203,000 to end of October). The Council now expects to exceed the investment income budget of £270,000 this financial year.
- Overall interest rate achieved from investments for the first six months of 2012/13 is 1.63% (benchmark 7 day LIBID un compounded rate is 0.43%).

**5. RECOMMENDATION**

**It is recommended that:-**

- (i) Members note the report.

**It is recommended to Council that:-**

- (ii) The revised TMSS creditworthiness policy (paragraph 5) and increase in the CFR prudential indicator (paragraph 4) be approved.

<b>Wards Affected</b>	All
<b>Forward Plan Reference No. (if applicable)</b>	Not applicable
<b>Portfolio Holder(s)</b>	Cllr Alan Melton, Leader and Portfolio Holder, Policy and Resources Cllr John Clark, Portfolio Holder, Quality Organisation
<b>Report Originator</b>	Rob Bridge, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
<b>Contact Officer(s)</b>	Rob Bridge, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
<b>Background Paper(s)</b>	Sector Treasury Services Ltd template Cabinet Report 1 March 2012 General Fund Budget 2012/13 and Capital Programme 2012/15

## 1. INTRODUCTION

- 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 Council complies with the requirements of The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice 2011.
- 1.3. The primary requirements of the Code are as follows:
  - Creation and maintenance of a Treasury Management Policy Statement, which sets out the policies and objectives of the Council’s treasury management activities.
  - Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives.
  - Receipt by full Council of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy – for the year ahead and an Annual Report covering activities during the previous year.
  - 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.
  - Delegation by Council of the role of scrutiny of treasury management strategy and policies (including Mid-year Review Report) to a specific named body. For this Council the delegated body is: Corporate Governance Committee.
- 1.4. 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;
  - the Council’s capital position;
  - a review of the Council’s investment portfolio for 2012/13;
  - a report of the Council’s borrowing strategy for 2012/13;
  - a report of debt rescheduling during 2012/13;
  - a review of compliance with Treasury and Prudential Limits for 2012/13.

## 2. **ECONOMIC UPDATE**

- 2.1. Prospects for the UK economy to recover swiftly 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.
- 2.2. 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 but also America and the Far East.
- 2.3. 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. It is 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.
- 2.4. 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 June the Bank of England and the Government announced schemes to free up banking funds for business and consumers.
- 2.5. Looking forward the 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 bail out.
- 2.6. 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. Concern remains that the Bank's forecasts of a weaker and delayed robust recovery may still 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 is likely to be hampered in promoting growth by the requirements of maintaining austerity measures to tackle the budget deficit.
- 2.7. The overall balance of risks is weighted to the downside, expectation of low growth in the UK to continue, with a low bank rate to continue for at least 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 rise.
- 2.8. Prospects for interest rates and borrowings over the medium term are shown below.

	NOW	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
<b>BANK RATE</b>	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	1.75
3 month LIBID	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.60	0.70	0.80	1.10	1.40	1.70	1.90
6 month LIBID	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.30	1.60	1.90	2.20
12 month LIBID	0.90	1.00	1.00	1.00	1.00	1.00	1.10	1.10	1.20	1.30	1.30	1.50	1.80	2.10	2.40
5 yr PWLB	1.60	1.50	1.50	1.50	1.60	1.60	1.70	1.70	1.80	2.00	2.20	2.30	2.50	2.70	2.90
10 yr PWLB	2.50	2.50	2.50	2.50	2.60	2.60	2.70	2.70	2.80	3.00	3.20	3.30	3.50	3.70	3.90
25 yr PWLB	3.80	3.70	3.80	3.80	3.80	3.80	3.90	3.90	4.00	4.10	4.30	4.40	4.60	4.80	5.00
50 yr PWLB	3.90	3.90	4.00	4.00	4.00	4.00	4.10	4.10	4.20	4.30	4.50	4.60	4.80	5.00	5.20

### 3. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

3.1. The Treasury Management Strategy Statement (TMSS) for 2012/13 was approved by the Council on 1 March 2012. The underlying TMSS requires revision to the creditworthiness policy in the light of the updated economic and operational movements during the year (paragraph 5) and approval of the revised CFR prudential indicator.

### 4. THE COUNCIL'S CAPITAL POSITION

4.1. This part of the report is structured to update:

- the Council's capital expenditure plans;
- how these plans are being financed;
- the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- compliance with limits in place for borrowing activity.

4.2. This table shows the revised estimates for capital expenditure and financing of the capital programme and the changes since the budget was approved.

<b>Capital Programme</b>	<b>2012/13 Original Estimate £000</b>	<b>2012/13 Revised Estimate £000</b>
<b>Forecast Capital Expenditure</b>	<b>5,033</b>	<b>5,512</b>
Financed by:		
Capital Receipts	1,500	750
Capital Grants	580	845
Capital Reserves	2,953	3,857
Section 106 Contributions	0	60
<b>Total Financing</b>	<b>5,033</b>	<b>5,512</b>

4.3. The main changes from the capital programme approved in March 2012, is the reprofiling of expenditure and capital resources between 2011/12 and 2012/13. In addition receipts from the sale of assets have been reduced by £750k in 2012/13, as considerable uncertainty remains as to when sales will be realised.

4.4. The table below 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.

<b>Prudential Indicators</b>	<b>2012/13 Original Estimate £000</b>	<b>2012/13 Revised Estimate £000</b>
<b>Capital Financing Requirement</b>	364	533
<b>External Debt / Operational Boundary</b>		
Borrowing	7,800	7,800
Other Long Term Liabilities Finance Leases	364	528
<b>Total Debt 31 March</b>	<b>8,164</b>	<b>8,328</b>

- 4.5. The Council's revised estimate for CFR is £169k higher than the original estimate. This reflects the leasing of equipment for the Chatteris leisure complex. Whilst this increases the CFR and therefore the Council's borrowing requirement, this type of lease includes a borrowing facility and so the Council is not required to separately borrow to fund these leases. The Council has made provision to repay this lease liability in the General Fund revenue budget.
- 4.6. 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 CFR in the preceding year plus the estimates of any additional CFR for 2012/13 and the next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

<b>Limits to Borrowing Activity</b>	<b>2012/13 Original Estimate £000</b>	<b>2012/13 Revised Estimate £000</b>
Gross Borrowing	7,800	7,800
Plus Other Long Term Liabilities Finance Leases	364	528
Less Investments	(12,000)	(11,000)
<b>Net Borrowing</b>	<b>(3,836)</b>	<b>(2,672)</b>
Capital Financing Requirement	364	533

- 4.7. 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. It reflects the level for 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.

<b>Authorised Limit for External Debt</b>	<b>2012/13 Original</b>	<b>2012/13 Revised</b>

	<b>Estimate £000</b>	<b>Estimate £000</b>
Borrowing	15,000	15,000
Plus Other Long Term Liabilities Finance Leases	2,000	2,000
<b>Total Borrowing</b>	<b>17,000</b>	<b>17,000</b>

- 4.8. The Corporate Director & Chief Finance Officer reports that no difficulties are envisaged for the current year in complying with the above prudential indicators.

## 5. INVESTMENT PORTFOLIO

- 5.1. 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 2, 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.
- 5.2. The Council held investments of £22.5m as at the 30 September 2012 (£17.6m at 31 March 2012) and the investment portfolio yield for the first 6 months of the year is 1.63% against a benchmark (7 day LIBID un compounded rate) of 0.43%.
- 5.3. The Chief Finance Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2012/13. The Council has achieved investment income of £170k to 30 September 2012 and now expect to exceed the budget (£270k) for 2012/13.
- 5.4. The Council's current investment counterparty criterion was approved in the TMSS in March 2012 and has met the requirements of the treasury management function to date. However, the continued economic slowdown and intensification of banking regularity requirements is a challenging environment for banks as they continue to strength their balance sheets to remain solvent and increase profitability.
- 5.5. The Council creditworthiness policy is based on a sophisticated modeling approach supported by Sector (the Council's treasury management advisors), the basis of which utilises credit ratings from the three credit ratings agencies- Fitch, Moody's and Standard and Poors. This credit rating information is supported by addition information including credit default swaps and other market information.
- 5.6. The Council's own bank currently meets the creditworthiness policy. However, should they fall below Sectors creditworthiness policy the Council will retain the bank on its Counterparty list for transactional purposes, though would restrict cash balances to a minimum.

## 6. BORROWING STRATEGY



- 6.1. No new borrowing has been undertaken in the first six months and none is anticipated during the remainder of this financial year, as stated in the TMSS report (1 March 2012).

## **7. DEBT RESCHEDULING**

- 7.1. Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2012/13.