ASSEMBLY

5 December 2012

Title: Treasury Management Strategy Statement Mid-year Review Report 2012/13	
Report of the Cabinet Member for Finance	
Open Report	**For Decision**
Wards Affected: None	**Key Decision:** Yes
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Accountable Divisional Director: Jonathan Bunt, Divisional Director of Finance	
Accountable Director: Graham Farrant, Chief Executive	

Summary:

Recent changes in the regulatory environment now place a greater onus on Elected Members for the review and scrutiny of treasury management policy and activities. This report, Treasury Management Strategy Statement Mid-year Review Report 2012/13, is important in that respect, as it provides details of the mid-year position for treasury activities and highlights compliance with the Council's policies previously approved by the Assembly.

The Council agreed the Treasury Management Strategy Statement for 2012/13 on 22 February 2012 which incorporates the Prudential Indicators. This report updates Members on treasury management activities in the current year and seeks approval to a change to the Council's Investment Strategy.

Recommendation(s)

The Assembly is asked to:

(i) Note the report, the treasury activity, the prudential indicators and risk study results; and

(ii) Agree to the following changes to the Council's Investment Strategy, as detailed in section 6 of the report:

1. Increase the limit on investment with Lloyds TSB from £30m to a maximum of 40% of the average monthly cash available to invest; and

2. Set a fixed investment limit of £40m to be invested with Lloyds TSB after which all additional investment need to be invested in the Lloyds TSB call account.

Reason(s)

This report is required to be presented to the full Council in accordance with the revised CIPFA Code of Practice for Treasury Management in the Public Services.

1. Background

1.1 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 counterparties of an appropriate level of risk, providing adequate liquidity before considering maximising investment return.

1.2 The second main function of treasury management is the funding of the Council's capital programme. These capital plans provide a guide to the Council's borrowing need, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 As a consequence, treasury management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) 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

2.1 The CIPFA Code of Practice on Treasury Management 2011 requires the:

I. Creation and maintenance of a Treasury Management Policy Statement (TMPS) which sets out the policies and objectives of the Council's treasury management activities.
II. Creation and maintenance of Treasury Management Practices (TMP) which set out the manner in which the Council will seek to achieve those policies and objectives.
III. 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.
IV. 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.
V. 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 Cabinet.

2.2 This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- A summary of the Treasury Position at 30 September 2012;
- The Council's debt position as at 30 September 2012;
- A review of the Council's investment portfolio for 2012/13;
- A recommendation to a change in the investment strategy;
- The Council's capital expenditure (prudential indicators);
- A review of compliance with Treasury and Prudential Limits for 2012/13;
- Results of a recent risk study on the Council's treasury strategy;
- An economic update for the first six months of 2012/13 (**Appendix 1**); and
- A list of investments held as at 30 September 2012 **(Appendix 2)**.

2.3 Proposed key changes to the Treasury and Capital Strategies:

As part of the review of the Council's investment portfolio, a change is requested to the investment strategy. The recommendations are below, with the reasons and further details contained in section 6 of this report.

- Increase the limit on investment with Lloyds TSB from £30m to a maximum of 40% of the average monthly cash available to invest; and

- Set a fixed investment limit of £40m to be invested with Lloyds TSB after which all additional investment needs to be invested in the Lloyds TSB call account.

3. Treasury Position at 30 September 2012

3.1 Table 1 below details the Council's mid year treasury position.

Table 1: Council's treasury position at 30 September 2012

	Principal Outstanding 30/09/2012 £'000	**Rate of Return 30/09/2012 %**	**Average Life 30/09/2012 (yrs)**
Fixed Rate Funding:			
PWLB	285,912	3.55	38.96
Variable Rate Funding:			
PWLB	0	0	0
Market	40,000	4.02	55.89
Total Debt	**325,912**	**3.61**	**41.04**
Investments			
In-House	75,014	1.85	
External Managers:			
Investec	38,944	1.03	
Total Investments	**113,958**	**1.57**	

4. Debt Position as at 30 September 2012

4.1 The Council's capital financing requirement (CFR) for 2012/13 is forecast to be £506.72m. 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.

4.2 On 27 April 2012 £10m of PWLB borrowing was paid back as it had reached its maturity date. As there was sufficient cash held by the Council to meet the 2012/13 CFR the £10m borrowing was not replaced although officers continue to closely monitor the Council's cash-flow to ensure that sufficient liquidity is available.

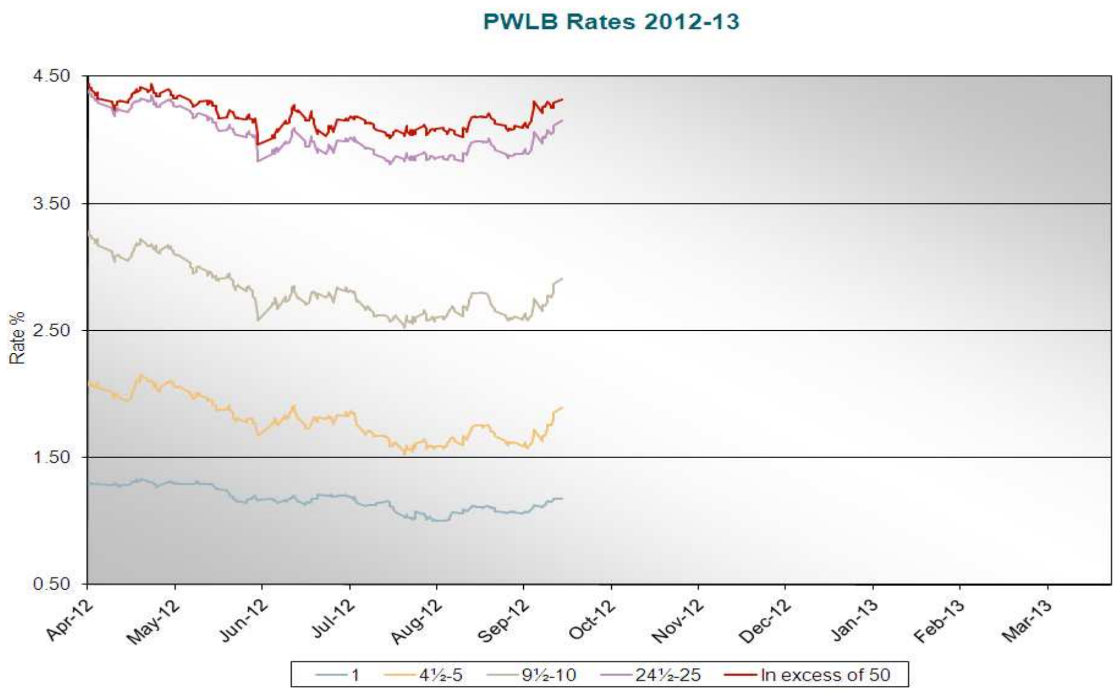
4.3 As the interest rate paid on the £10m was 3.85%, this reduced the interest payments by over £350k for 2012/13. The reduction in interest payments was negated by rate increases on two other tranches of borrowing as their initial low variable rates increased to the current fixed rates of 4.05% and 4.07% respectively.

4.4 Due to large cash balances held, internal borrowing is still preferred over external borrowing. While borrowing rates remain significantly higher than investment rates the Council will seek to delay new loans as long as possible, whilst monitoring the latest rate forecasts to ensure any new loans are undertaken before base rate rises.

4.5 As outlined below, the general trend has been a slight reduction in interest rates during the six months, across all maturity bands. It is anticipated that further borrowing will not be undertaken during this financial year.

4.6 Chart 1 below shows the movement in PWLB rates for the first six months of the financial year (to 30 September 2012):

Chart 1: Movement in PWLB rates (1 April to 30 September 2012)



4.7 Table 2 shows the General Fund debt held as at 30 September 2012. The current General Fund borrowing is now £60m.

Table 2: General Fund Debt held as at 30 September 2012

Borrowing/Loan Held	Interest Rate	Fixed/ Variable	Principal	2012/13 Interest	Term End date
494971 - PWLB	4.07%	Fixed	10,000,000	407,000	26/04/2013
494972 - PWLB	4.25%	Fixed	10,000,000	425,000	28/04/2014
Long Term - Barclays	3.98%	Fixed	10,000,000	398,000	30/05/2078
Long Term - Dexia	3.97%	Fixed	10,000,000	397,000	30/06/2077
Long Term - RBS	4.05%	Fixed	10,000,000	405,000	27/02/2060
Long Term - RBS	4.07%	Fixed	10,000,000	407,000	26/03/2055
Total	**4.07%**		**60,000,000**	**2,439,000**	

4.8 Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate. During the first six months of the year, no debt rescheduling was undertaken.

4.9 Certainty Rate (20bps reduction in borrowing costs) Update

4.9.1 The Office for Budgetary Responsibility (OBR) is keen to have clearer sight of funding data as they currently receive outdated data. As an incentive for local authorities to submit returns they have allowed compliant local authorities to borrow from the Public Works Loan Board (PWLB) at 20 basis points (bps) lower than currently available.

4.9.3 HM Treasury stated that this exercise should be seen as a light-touch approach that is simply seeking clarity of funding plans and helps the Treasury allocate its scarce funding resources more accurately. The key message was that local authorities should comply with the 17 September 2012 deadline.

4.9.3 With regard to the information requested, local authorities were asked to provide a summary of their internal borrowing positions based on its best estimate of future funding.

4.9.4 The OBR return was submitted on 17 September 2012 and the Council can access the 20bps discount from 1 November 2012.

4.9.5 Detail on the discount rates that would apply to the early repayment of these loans will be clarified by the PWLB in their October circular, which has not yet been received.

5. Investment Portfolio 2012/13

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. Currently the investment market is difficult in terms of earning the level of interest rates 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.

5.2 Given this risk adverse environment, investment returns are likely to remain low and are likely to reduce further into 2013. To reduce the effects of the decrease in return and investment income, treasury invested in a number of one year deals to lock in the relatively high rates that were available at the start of the financial year. This has allowed both an increase in investment income as well as secured the higher than average returns into 2013/14.

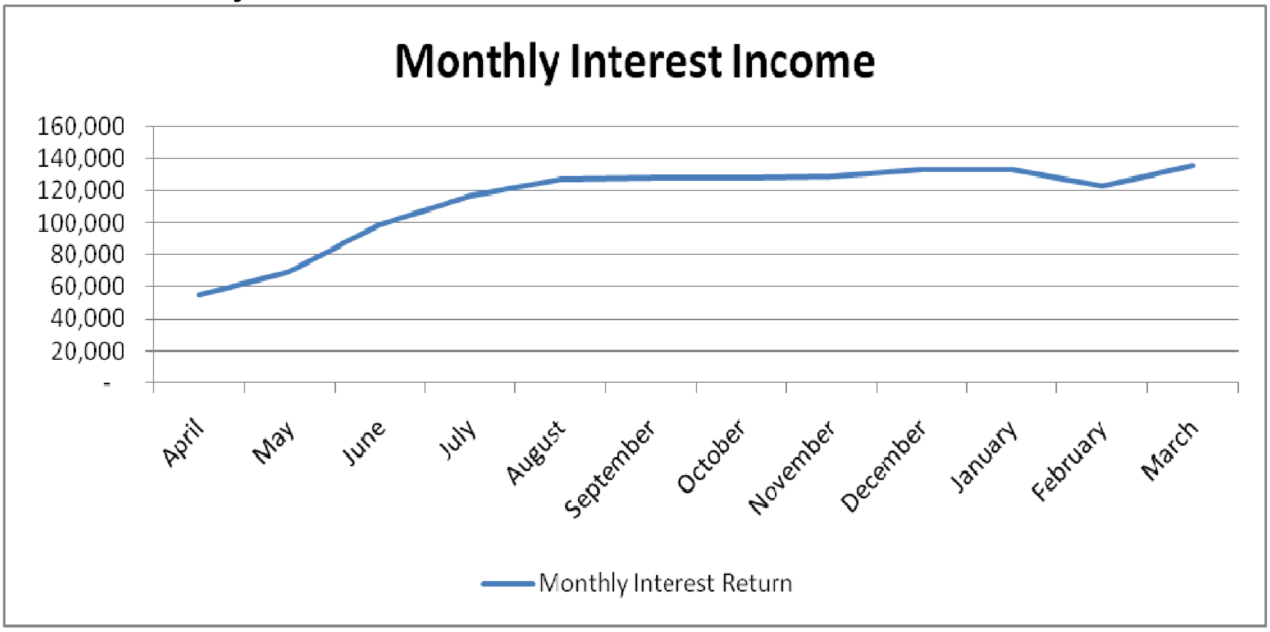
5.3 As at 30 September 2012 the Council held £114m of investments (£99.5m at 31 March 2012) and the investment portfolio yield for the first six months of the year was 1.57%. A full list of investments held as at 30 September 2011 is in **Appendix 2**.

5.4 For the remaining six months of the year a combination of increased cash balances and better than expected one year investment returns will improve the overall return to an estimated 1.75%.

5.5 The Divisional Director of Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2012/13.

5.6 Chart 2 below provides a summary of the actual monthly income between April and September 2012 and provides a forecast of the expected monthly interest income for the remaining six months of the year.

Chart 2: Monthly interest income 2012/13

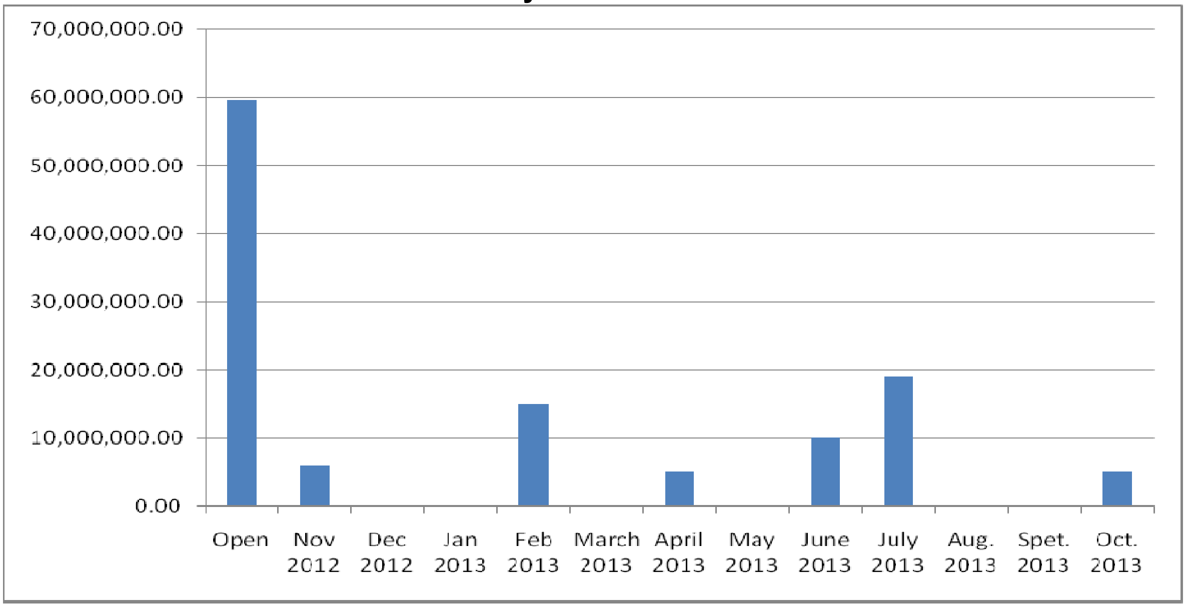


5.7 Investment Profile

5.7.1 The maturity profile of the Council's investments in Chart 3 below shows that the Council holds 54.85% (down from 90% at 31 March 2012) for 90 days or less.

5.7.2 Spreading out the maturity of longer dated investments allows the Council to take advantage of improved rates of return over one year while ensuring sufficient liquidity is available to cover its future borrowing requirement.

Chart 3: Investment Profile for the year November 2012 to October 2013



5.7.3 In line with the Council strategy of not investing over a period greater than one year, all investments mature within one year.

6. Change to Investment Strategy

6.1 The Council's investments are managed on the following principles, in order of priority:

- **Security** – minimising the risk of losing cash arising from a bank failure and consequent default;
- **Liquidity** – ensuring the Council will have access to cash as required to meet daily expenditure obligations;
- **Yield** – after ensuring the above are met, the Council will aim to maximise earnings on cash invested.

6.2 The current investment counterparty criteria selection approved in the Treasury Management Strategy Statement is meeting the requirement of the treasury management function. However, as a result of increased cash balances, investing in the two part nationalised banks, RBS and Lloyds TSB, is limited to a set amount of £30m each.

6.3 While this limit is sufficient for RBS, a variable limit of 40% of the average monthly balance is requested for Lloyds TSB. Of the 40% a cash limit of £40m is requested for fixed deposits of up to a year with and cash invested over the £40m limit to be invested in an overnight call account.

6.4 The reasoning to increase the limit for Lloyds includes:

1. It will allow flexibility in managing the exposure of the Council to the part nationalised bank, with the exposure reduced or increased according to the overall size of the cash available to invest.
2. The Council's advisers, Sector, continue to view the current significant UK ownership of Lloyds as providing significant comfort to investors.
3. Lloyds currently provide excellent returns over one year and the ability to increase the allocation will result in improved returns to the Council.
4. Lloyds TSB's share price has improved over the year and it is up 61.22% (as at 16 October 2012) for the year to date.
5. The Government still holds 43.4% of Lloyds TSB shares and there is currently no evidence to suggest that there will be a sale of the Government's stake. Therefore the quasi-government guarantee for Lloyds is likely to remain until at least the next formal Strategy Review in February 2013.
6. The £40m limit on fixed investments will set a cap on the Council's exposure to Lloyds over fixed durations and will allow amounts over the £40m cap to be invested in a call account that can be accessed daily.
7. Lloyds TSB is the Council's bank and it will allow daily dealing to be managed within the 40% limit restrictions.

7. The Council's Capital Position (Prudential Indicators)

7.1 <u>Prudential Indicator for Capital Expenditure</u>

Table 3 below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Table 3: Revised Estimate to Capital Programme as at 30 September 2012

Capital Expenditure by Service	2012/13 Original Estimate £m	2012/13 Revised Estimate £m
Adult & Community Services	4.472	5.977
Children's Services	47.213	61.969
Housing & Environment	4.231	7.501
HRA	60.700	49.353
Finance& Resources	28.223	21.783
Total	**144.839**	**146.583**

7.2 <u>Changes to the Financing of the Capital Programme</u>

Table 4 draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Table 4: Revised Borrowing need as at 30 September 2012

Capital Expenditure	2012/13 Original Estimate £m	2012/13 Revised Estimate £m
Supported		
Unsupported	144.839	141.583
Total spend	**144.839**	**141.583**
Financed by:		
Capital receipts	3.000	5.102
Capital grants & conts.	57.875	87.296
Capital reserves	36.700	18.189
Revenue		1.625
Total financing	**97.575**	**112.212**
Borrowing need	**47.264**	**29.371**

7.3 Prudential Indicator – Capital Financing Requirement

The Council is on target to achieve the original forecast Capital Financing Requirement (Prudential Indicator – External Debt / the Operational Boundary).

Table 5: Revised Capital Financing Requirement as at 30 September 2012

	2012/13 Original Estimate £m	2012/13 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement		
CFR – non housing	255.838	238.096
CFR – housing	274.622	268.622
Total CFR	530.460	506.718
Net movement in CFR		**(23.742)**
Prudential Indicator – External Debt / the Operational Boundary		
Borrowing	382.264	325.912
Other long term liabilities	49.000	58.000
Total debt 31 March	**431.264**	**383.912**

7.4 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 2012/13 and 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.

Table 6: Revised Borrowing Limits as at 30 September 2012

	2012/13 Original Estimate £m	2012/13 Revised Estimate £m
Gross borrowing	382.264	325.912
Plus other long term liabilities	49.000	58.000
Less investments	(48.000)	(115.000)
Net borrowing	**383.264**	**268.912**
CFR (year end position)	530.460	506.718

7.5 The Divisional Director of Finance and Resources reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

7.6 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 of 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.

Table 7: Authorised External Debt Limits and Current Position as at 30 September 2012

Authorised limit for external debt	2012/13 Original Indicator	Current Position
Borrowing	469.000	325.912
Other long term liabilities	59.000	58.000
Total	**528.000**	**383.912**

8. **Risk Exposure**

8.1 CIPFA has carried out a risk assessment of the Council's investments and treasury management. Overall the strategy is seen as positive, with the use of internal resources to fund the CFR being viewed as an appropriate option. A summary of the key risks analysed is provided below.

8.2 Interest Rate Risk

In comparison to other Local Authorities (LAs) in the risk study, for the level of return achieved (1.65% as at 30 June 2012), the risk taken is low and the study highlighted that the Council is taking less risk, for better return than the majority of other LAs in the study. Overall as at 30 June 2012 the Council was ranked 20 out of 165 LAs in the study for return.

8.3 Weighted average duration

A comparison of the Council's investment duration (how long each investment is invested for) was made with other participating LAs in the Risk Study. Overall the Council invested for a longer duration than other LAs. Investing for a longer duration is riskier than a shorter term investment but returns are higher. The results were skewed by many LAs not investing for longer than 3 months, with the actual risk being taken by the Council being low.

8.4 Credit risk compared to the expected return

Comparing the credit risk of the institutions the Council is invested in to the return achieved provides an indication as to whether the credit risk being taken is being rewarded in respect of returns. The Council is near the LAs average for credit risk but is towards the top of the return. Again the results are skewed by a large number of LAs only investing in very low risk institutions which results in very low risk but also much lower returns on investments.

9. Options Appraisal

9.1 There is no legal requirement to prepare a Treasury Management Strategy Statement Mid-year Review; however, it is good governance to do so and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

10. Consultation

10.1 The Divisional Director of Finance has been informed of the approach, data and commentary in this report.

11. Financial Implications

Implications completed by: Jonathan Bunt
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11.1 This report sets out the midyear position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long term borrowing positions.

12. Legal Implications

Implications completed by: Eldred Taylor-Camara (Legal Group Manager)
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E-mail: eldred.taylor-camara@lbbd.gov.uk

12.1 The Legal Practice has been consulted in the preparation of this report and confirms there are no legal implications to highlight.

13. Risk Management

13.1 The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income during the first 6 months of the year.

14. **Contractual Issues**

No specific contractual issues.

15. **Staffing Issues**

No staffing issues.

16. **Customer Impact**

No specific implications.

17. **Safeguarding Children**

No specific implications.

18. **Health Issues**

No specific implications.

19. **Crime and Disorder Issues**

No specific implications.

20. **Property / Asset Issues**

No specific implications.

Background Papers Used in the Preparation of the Report:

- Treasury Management Strategy Statement - Assembly Report 22 February 2012
- CIPFA – Revised Treasury Management in the Public Sector
- CIPFA – Revised Prudential Code for Capital Finance in Local Authorities

List of appendices:

Appendix 1 - Sector's Economic update
Appendix 2 - Investments held as at 30 September 2012