London Borough of Hammersmith & Fulham

# Cabinet

**5 DECEMBER 20**

**LEADER**
*Councillor Stephen Greenhalgh*

**TREASURY MANAGEMENT UPDATE FOR THE FIRST SIX MONTHS OF 2011-12**

**Wards: All**

This report provides information on the Council's debt, borrowing and investment activity up to 30 September 2011

**CONTRIBUTORS**

ED FCG

**HAS A EIA BEEN COMPLETED? N/A**

**HAS THE REPORT CONTENT BEEN RISK ASSESSED? N/A**

**Recommendations:**

**That the Council's debt, borrowing and investment activity up to the 30 September 2011 be noted.**

## 1. INTRODUCTION

1.1 Treasury management is defined by the CIPFA Code of Practice 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 CIPFA Code of Practice on Treasury Management (revised November 2009) has been adopted by the Council.

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, for the year ahead, a Mid-year Review Report (this report) and an Annual 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 the Audit and Pensions Committee.

1.3 This mid-year review has been prepared in compliance with the Code of Practice, and covers the following

- An economic update for the first six months of 2011/12
- A review of the Annual Treasury Strategy
- A review of the Council's investment portfolio for 2011/12
- A review of the Council's borrowing strategy for 2011/12
- A review of compliance with Prudential Code indicators for 2011/12

## 2. ECONOMIC UPDATE

2.1 The Euro zone sovereign debt crisis continued: Spain and Italy became 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 co-ordinated or credible Euro zone response caused anxiety over the potential impact of sovereign default and resulting effect on the Euro zone banking sector. The approval by various countries of the 440 billion euro bail out fund in September has brought temporary relief to financial markets but does not provide a remedy to the scale of the Greek debt problem or the sheer magnitude of the potential needs of other countries for support.

2.2 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 Poor's, has led to a much more difficult and uncertain outlook for the world economy. Growth prospects in the US, UK and the euro zone have receded. World stock markets fell in the second quarter of 2011/12 as a consequence.

2.3 Following zero growth in the final half of 2010/11 the UK economy grew by a weaker than expected 0.1% in the first quarter of 2011/12. Overhanging debt, high inflation and concerns over employment are likely to impede growth in the short term.

2.4 The announcement by the MPC on 6 October of a second round of quantitative easing of £75bn reflected the threat of recession. Although inflation remains stubbornly high, the MPC's expectation of future falls will result in a reduction below 2%. The longer term 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

2.5 International investors continue to view UK government gilts as being a safe haven from the EU sovereign debt crisis. The increase in demand for gilts has helped to lower yields and reduce PWLB rates to low levels.

2.6 The Council's Treasury Adviser, Sector, has provided the following interest rate forecast:

Table 1 – Interest Rate Forecast

| | Oct 11 % | Dec-11 % | **Mar-12 %** | Jun-12 % | Sept-12 % | Dec-12 % | **Mar-13 %** | Jun-13 % | Sept-13 % | Dec-13 % | **Mar-14 %** | Jun-14 % | Sep-14 % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Sector's Bank Rate | 0.50 | 0.50 | **0.50** | 0.50 | 0.50 | 0.50 | **0.50** | 0.50 | 0.75 | 1.00 | **1.25** | 1.50 | 2.00 |
| 5 yr PWLB Rate | 2.30 | 2.30 | **2.30** | 2.30 | 2.30 | 2.40 | **2.50** | 2.60 | 2.70 | 2.80 | **2.90** | 3.10 | 3.30 |
| 10 yr PWLB | 3.30 | 3.30 | **3.30** | 3.30 | 3.40 | 3.40 | **3.50** | 3.60 | 3.70 | 3.80 | **4.00** | 4.20 | 4.40 |
| 25 yr PWLB | 4.20 | 4.20 | **4.20** | 4.20 | 4.30 | 4.30 | **4.40** | 4.50 | 4.60 | 4.70 | **4.80** | 4.90 | 5.00 |
| 50 yr PWLB | 4.30 | 4.30 | **4.30** | 4.30 | 4.40 | 4.40 | **4.50** | 4.60 | 4.70 | 4.80 | **4.90** | 5.00 | 5.10 |
| | | | | | | | | | | | | | |
| 3mth LIBID | 0.75 | 0.70 | **0.70** | 0.70 | 0.70 | 0.70 | **0.75** | 0.80 | 0.90 | 1.20 | **1.40** | 1.60 | 2.10 |
| 6 mth LIBID | 1.00 | 1.00 | **1.00** | 1.00 | 1.00 | 1.00 | **1.10** | 1.20 | 1.40 | 1.60 | **1.80** | 2.00 | 2.50 |
| 12 mth LIBID | 1.50 | 1.50 | **1.50** | 1.50 | 1.50 | 1.60 | **1.70** | 1.80 | 1.90 | 2.20 | **2.40** | 2.60 | 3.10 |

## 3. ANNUAL INVESTMENT STRATEGY

3.1 The Treasury Management Strategy for 2011/12 was approved by Council on 23rd February 2011. The Council's Annual Investment Strategy, which is incorporated in the overall strategy, outlines the Council's investment priorities as follows:

- Achieve optimum returns on investment subject to;
- Security of Capital
- And a level of Liquidity in its investments appropriate to the Council's need of funds over time.

3.2 In the current economic climate it is considered appropriate to keep all new investments short term, and only invest with highly credit rated financial institutions using the Sector suggested creditworthiness matrices.

3.3 It should be noted that the reason we have Lloyds and RBS on the Council's lending list and with limits of £35 million is not because of their credit ratings but because of the fact that they are part nationalised.

3.4 Investments within the first 6 months of the year have been in line with strategy. A full list of investments held as at 30 September 2011 are as follows:

Table 2 – Investments at 31 October 2011

| **Money Market Fund** | **Principal £'m** | **Interest Rate** | **Start Date** | **Maturity Date** |
|---|---|---|---|---|
| Primerate Capital | 10 | 0.88% | | Call |
| Insight Investments | 6.0 | 0.70% | | Call |
| Blackrock | 0.6 | 0.70% | | Call |
| **Bank** | | | | |
| National Westminster Bank | 20 | 0.87% | | Call |
| Lloyds Bank | 5 | 1.90% | 19/11/10 | 18/11/11 |
| Lloyds Bank | 5 | 1.45% | 20/07/11 | 20/01/12 |
| Lloyds Bank | 5 | 1.25% | 21/10/11 | 23/01/12 |
| NatWest Bank | 5 | 1.28% | 19/05/11 | 20/02/12 |
| NatWest Bank | 5 | 1.21% | 01/08/11 | 01/05/12 |
| Lloyds Bank | 5 | 2.65% | 02/06/11 | 27/07/12 |
| Lloyds Bank | 5 | 2.65% | 19/05/11 | 27/07/12 |
| NatWest Bank | 5 | 1.42% | 01/08/11 | 30/07/12 |
| Lloyds Bank | 5 | 2.10% | 03/08/11 | 01/08/12 |
| | | | | |
| **Total Investments** | **81.6** | | | |

3.5 Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the first half of 2011/12.

3.6 Investment rates available in the market are at an historical low point. The table below shows that the authority outperformed the benchmark by 0.74%.

Table 3 – Investment Performance against benchmark

| **Benchmark** | **Benchmark Return Average Rate as at 30/09/11** | **Council Performance as at 30/09/11** |
|---|---|---|
| 7 days LIBID | 0.46% | 1.20% |

## 4. OUTSTANDING DEBT AND INVESTMENTS

4.1 This table below shows the Council's outstanding debt and investments at 30th September 2011 compared to 31st March 2011

Table 4 – Debt and Investments at 31st March & 30st September 2011

| | 31 March 2011 | | 30 September 2011 | |
|---|---|---|---|---|
| | £000's | | £000's | |
| | Principal | Ave. Rate | | Ave. Rate |
| Fixed Rate PWLB | 475,520 | 5.75% | 468,520 | 5.70% |
| Variable Rate PWLB | Nil | | Nil | |
| Market & Temporary Loan | Nil | | Nil | |
| **Total Loans** | **475,520** | | **468,520** | |
| | | | | |
| **Total Investments** | **100,300** | 0.96% | **86,600** | 1.20% |
| **Net Borrowing** | **375,220** | | **381,920** | |

It is quite usual for cash balances to fluctuate daily but at the end of September a PWLB loan of £7 million matured and was repaid which has resulted in a reduction in overall cash balances.

4.2 This table below shows the split of the Council's debt between the HRA and General fund.

Table 5 – HRA & GF debt

| | 31 March 2011 | | 30 September 2011 (Estimate) |
|---|---|---|---|
| | £'000 | | £'000 |
| **HRA** | **414,527** | | **414,678** |
| **GF** | **60,993** | | **53,842** |
| **Total Debt** | **475,520** | | **468,520** |

4.3 The General Fund Capital Financing Requirement (CFR) was £122 million as at 31/03/11 compared to £132 million as at 31/03/10 million a reduction of £10 million. The HRA CFR was £416 million as at 31/03/11 compared to £406 million as at 31/03/10 an increase of £10 million. The increase in HRA CFR is due to the delivery of the decent homes programme. The total CFR is £538 million as at the 31/03/11. The CFR represents the underlying need to borrow and is higher than the actual level of debt due to the temporary borrowing of internal resources.

4.4 The proposed reform of the HRA subsidy arrangements is expected to take place on 28 March 2012. This will involve the Council debt being reduced by an estimated £210.3 million which will remove the Council from the HRA subsidy system. Although this figure may change once national figures are recalculated, this will impact on the capital structure of the Council as the HRA capital financing requirement will reduce by the size of the CLG payment. The treasury management service will need to consider the treasury implications of the debt reduction.

## 5. PRUDENTIAL INDICATORS

5.1 As part of the Strategy the Council sets a number of prudential limits for borrowing. This section shows the Council's position against the prudential indicators for 2011/12 agreed by Council in February 2011. These are outlined below.

5.2 Limits to Borrowing Activity.

The Authorised Limit – This represents the expected maximum borrowing need with some headroom for any unexpected movements.

The Operational Boundary – This indicator is the focus of day to day treasury management activity within the authority. It is a means by which the authority manages its external debt to ensure that it remains within the self imposed Authorised Limit. Sustained breaches of the Operational Boundary would give an indication that the authority may be in danger of stepping beyond the Prudential boundaries it has set itself.

5.3 Interest Rate Exposures

Interest rate risk management is a top priority for local authority management. While fixed rate borrowing and investment can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance may justify, or even demand, retaining a degree of flexibility through the use of variable interest rates on at least part of a treasury management portfolio. This is a best practice approach to treasury management and is to be encouraged to the extent that it is compatible with the effective management and control of risk. The key indicators are :

a) Upper Limit on fixed rate exposure – This indicator identifies a maximum limit for fixed interest rates based upon the debt position net of investments.

b) Upper Limit on variable rate exposure – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

c) Total principal funds invested for periods longer then 364 days – These limits are set to reduce the need for early sale of an investment, and are based on the availability of investments after each year-end.

5.4 The above key indicators are summarised in the table below.

Table 6 – Key Prudential Indicators

| | **2011/12 Limit** | **30 September 2011 Actual** |
|---|---|---|
| | **£000's** | **£000's** |
| Authorised Limit for external debt | 569,523 | 381,920 |
| Operational Limit for external debt | 495,520 | 381,920 |
| Limit of fixed interest rate exposure based on net debt | 544,000 | 381,920 |
| Limit of variable interest rate exposure based on net debt | 108,800 | Nil |
| Principal sum invested >364 days | 20,000 | Nil |

5.5 Maturity structure of borrowing – This indicator is designed to be a control over an authority having large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is not necessary to include variable rate debt because local authorities do not face substantial refinancing risks.

Table 7 - Maturity structure of fixed rate borrowing during 2011/12

| | **Upper Limit** | **Lower Limit** | **Actual** |
|---|---|---|---|
| Under 12 months | 15% | 0% | 0.00% |
| 12 months and within 24 months | 15% | 0% | 0.00% |
| 24 months and within 5 years | 60% | 0% | 9.14% |
| 5 years and within 10 years | 75% | 0% | 16.57% |
| 10 years and above | 100% | 0% | 74.29% |

## 6. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

6.1 During the first six months of the financial year the Council operated within its treasury limits and Prudential Indicators as set out in the Council's Treasury Strategy Report.

## 7. COMMENTS OF THE EXECUTIVE DIRECTOR OF FINANCE AND CORPORATE GOVERNANCE

7.1 The comments of the Executive Director of Finance and Corporate Governance are contained within this report.

## 8. COMMENTS OF THE ASSISTANT DIRECTOR (LEGAL AND DEMOCRATIC SERVICES)

8.1 There are no direct legal implications for the purpose of this report.

## 9. RECOMMENDATION

9.1 To note the Council's debt, borrowing and investment activity up to the 30th September 2011.

**Local Government Act 2000**
**List Of Background Papers**

| No. | Description of Background Papers | Name/Ext. of Holder of File/Copy | Department/ Location |
|---|---|---|---|
| 1 | Borrowings and Investments Ledger | Rosie Watson Ext. 2563 | Room 4 Hammersmith Town Hall |
| 2 | CIPFA-Prudential Code -Accounting for Capital Finance | Rosie Watson Ext. 2563 | Room 4 Hammersmith Town Hall |
| 3 | Various Economic commentaries | Rosie Watson Ext. 2563 | Room 4 Hammersmith Town Hall |