Report to Council

26 JANUARY 2011

LEADER *Councillor Stephen Greenhalgh*	**TREASURY MANAGEMENT MID YEAR REVIEW** This report provides information on the Council's debt, borrowing and investment activity up to 30 September 2010.	**WARDS** All
CONTRIBUTORS DFCS	**<u>RECOMMENDATIONS:</u>** **To note the Council's debt, borrowing and investment activity up to the 30 September 2010.**	

Treasury Management update for the six months of 2010/11

1. Introduction

1.1 CIPFA issued the revised Code of Practice for Treasury Management in November 2009 following consultation with Local Authorities during the summer. The revised Code suggests that members should be informed of Treasury Management activities at least twice a year. This report therefore ensures this Council is embracing Best Practice in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) revised Code of Practice.

1.2 This report covers both quarters and provides information on the Council's debt, borrowing and investment activity up to 30 September 2010.

2. Economic Background

2.1 The first six months of the financial year of 2010/11 saw:

- The new coalition government enact a fiscal squeeze set to be the most severe since the end of the 1930's, through its Emergency Budget on the 22 June;
- The labour market show some tentative signs of improvement;
- The UK's trade position deteriorate, despite the weak pound;
- The Monetary Policy Committee maintain Quantitative Easing (QE) and keep Bank Rate on hold at 0.5%; Quantitative easing is the purchase of government bonds or gilts by the Bank of England to increase the money supply.
- UK GDP increase 1.2% in the second quarter of 2010 which takes the annual figure up to 1.7%
- GDP forecast staying positive but low through 2010. Growth is expected to be slow, at a rate of just over 3% in two years time due to the extra fiscal tightening announced in the June budget;
- US GDP grow slower than initially estimated;
- EU growth grow at its fastest pace in more than three years, boosted by a strong performance by Germany and France;
- UK CPI Inflation in August remain its lowest since February at 3.1%,
- RPI remain high at 4.7% in August;
- Public Sector Net Borrowing post a record high in August at £15.3 billion as interest payments on gilts shot up because of higher inflation;
- British house prices rise 0.2 percent in August, confounding expectations for a decline (Halifax). It is expected that UK house prices with remain static overall in 2010;

- Nationwide report that house prices fell 0.9% in August due to a rise in the number of properties available.

3. Economic Forecast

3.1 The Council's Treasury Adviser, Sector, provides the following interest rate forecast:

Sector's Interest Rate View														
	NOW %	Sep-10 %	Dec-10 %	Mar-11 %	Jun-11 %	Sep-11 %	Dec-11 %	Mar-12 %	Jun-12 %	Sep-12 %	Dec-12 %	Mar-13 %	Jun-13 %	Sep-13 %
Sector's Bank Rate	0.50	0.50	0.50	0.50	0.50	0.75	1.00	1.25	1.50	2.00	2.50	3.00	3.25	3.25
5 yr PWLB Rate	1.96	2.20	2.20	2.20	2.40	2.60	2.80	3.00	3.30	3.60	3.80	4.10	4.40	4.40
10 yr PWLB	3.19	3.30	3.30	3.30	3.40	3.70	3.90	4.00	4.30	4.40	4.60	4.60	4.90	4.90
25 yr PWLB	4.09	4.20	4.20	4.30	4.30	4.40	4.50	4.70	4.70	4.80	5.00	5.00	5.00	5.00
50 yr PWLB	4.10	4.20	4.20	4.30	4.30	4.40	4.50	4.70	4.70	4.80	5.00	5.00	5.00	5.00

- The forecast is based on moderate economic recovery and moderate Monetary Policy Committee concerns about inflation looking 2 years ahead
- The first Bank Rate increase is expected to be in the quarter ending September 2011;
- Long term Public works loans Board (PWLB) rates are expected to steadily increase to reach 5% by the end of 2012 due to high gilt issuance, reversal of Quantitative Easing and investor concerns over inflation;
- The double dip recession worries have eased slightly in the UK but the economy is still fragile.
- There is considerable uncertainty in all forecasts due to the difficulties of forecasting the timing and amounts of QE reversal, the fiscal effect of a general election, speed of recovery of banks profitability and balance sheet position, changes in the consumer saving ratio, rebalancing of the UK economy in terms of export and import etc;
- Inflation is expected to fall below 2% in two years time even if interest rates remain at their record low.

4. Treasury Management Strategy Statement:

4.1 Annual Investment Strategy:

The Treasury Management Strategy for 2010/11 was approved by Council on 24 February 2010. The Council's Annual Investment Strategy, which is incorporated in the overall strategy, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will also aim to achieve the optimum return 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, and only invest with highly credit rated financial institutions using the Sector suggested creditworthiness matrices, including Credit Default Swap overlay information provided by Sector.

4.2 A full list of investments held as at 30 September 2010 are as follows:

Money Market Fund	**Principal £'m**	**Interest Rate**	**Start Date**	**Maturity Date**
Primerate	10	0.81%		Call
Insight	6.3	0.61%		Call
Bank				
National Westminster Bank	30	0.85%		Call
Thurrock Council	4	0.48%	19/05/10	19/10/10
Barclays Bank	10	1.44%	20/11/09	19/11/10
Lloyds Bank	5	1.82%	20/11/09	19/11/10
NatWest Bank	5	0.91%	19/05/10	19/11/10
Thurrock Council	5	0.48%	24/05/10	24/11/10
Lloyds Bank	5	1.50%	21/04/10	21/01/11
Lloyds Bank	5	1.82%	28/01/10	27/01/11
Lloyds Bank	5	1.84%	20/05/10	19/05/11
Lloyds Bank	5	1.84%	30/06/10	02/06/11
Lloyds Bank	5	2.05%	04/08/10	03/08/11
Total Investments	**100.3**			

4.3 Officers can confirm that the approved limits within the Annual Investment Strategy was not breached during the first half of 2010/11.

As illustrated in the interest rate section above, investment rates available in the market are at an historical low point. 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. The table below shows that the authority outperformed the benchmark by 0.54%**.**

Benchmark	Benchmark Return Average Rate as at 30/09/10	Council Performance as at 30/09/10
7 days	0.42%	0.96%

5. Outstanding Debt and Investments

5.1 This table shows the Council's outstanding debt and investments at 30 September 2010 compared to 31 March 2010.

	31 March 2010		**30 September 2010**	
	000's		**000's**	
	Principal	**Ave. Rate**		**Ave. Rate**
Fixed Rate PWLB	475,520	5.93%	475,520	5.75%
Variable Rate PWLB	Nil		Nil	
Market & Temporary Loan	Nil		Nil	
Total Loans	**475,520**		**475,520**	
Total Investments	**137,000**	1.24%	**100,300**	0.96%
Net Borrowing	**338,520**		**375,220**	

5.2 Breakdown of Debt

	31 March 2010		**30 September 2010 (Estimate)**
HRA	**404,634**		**409,732**
GF	**70,886**		**65,788**
Total Debt	**475,520**		**475,520**

5.3 Variation on Investment Balances

It is quite usual for cash balances to fluctuate daily but in the first six months there was a payment to the DCLG of £30 million relating to Non Domestic Rates which has resulted in a reduction in overall cash balances.

6. Prudential Indicators

6.1 This section shows the Council's position against the prudential indicators for 2009/10 agreed by Council in February 2009.

6.2 It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit" or "Authorised Limits". In England and Wales the authorised limits represent the legislative limits specified in Section 3 of the Local Government Act 2003.

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

Whilst termed an "Authorised Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements.

6.3 Limits to Borrowing Activity

a) The Authorised Limit – This represents the maximum amount the Council may borrow at any point in time in the year. It has to be set at a level the Council considers "prudent" and it 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 and encompasses borrowing for temporary purposes. It is not a limit that is designed to be brought into consideration during the routine financial management of the authority. That is the purpose of the Operational Boundary.

b) 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.

6.4 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.

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 that 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.

d)

	2010/11 Limit	**30 September 2010 Actual**
	000's	**000's**
Authorised Limit for external debt	506.991	375,220
Operational Limit for external debt	490,450	375,220
Limit of fixed interest rate based on net debt	493,000	375,220
Limit of variable interest rate based on net	98,000	Nil

debt		
Principal sum invested >364 days	20,000	Nil

6.5 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.

Maturity structure of fixed rate borrowing during 2010/11

	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%

7. Comments of the Director of Finance and Corporate Services

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

8. Comments of the Assistant Director (Legal and Democratic Services)

8.1 The statutory requirements are set out in the body of the report.

9. Comments of the Audit and Pensions Committee

9.1 The Audit and Pensions Committee considered this report at its meeting on 9 December 2010.

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