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| **REPORT TO:** | Executive Board Sub-Committee |
| **DATE:** | 3rd November 2011 |
| **REPORTING OFFICER:** | Operational Director – Finance |
| **TITLE:** | Treasury Management 2011/12<br>Mid Year Review |

## 1.0 PURPOSE OF REPORT

1.1 The purpose of the report is to update the Sub-Committee about activities undertaken at the mid-year point of 2011/12 as required by the Treasury Management Policy.

**2.0 RECOMMENDED: That Council be recommended to approve the revised Prudential Indicators and the increase in counterparty limits for Lloyds/TSB and Royal Bank of Scotland.**

## 3.0 SUPPORTING INFORMATION

3.1 The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity before considering investment return.

3.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, 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

3.3 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by full Council on 3rd March 2010.

3.4 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 the Executive Board Sub-Committee.

3.5 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 2011/12;
- A review of the Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy (AIS);
- The Council's capital expenditure (prudential indicators);
- 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 any debt rescheduling undertaken during 2011/12;
- A review of compliance with Treasury and Prudential Limits for 2011/12.

## 4.0 KEY CHANGES TO THE TREASURY AND CAPITAL STRATEGIES

4.1 There have been no material changes to the treasury or capital strategies for the first 6 months of 2011/12.

## 5.0 ECONOMIC UPDATE

5.1 Global economy

The Euro zone sovereign debt crisis continued with Spain, and particularly Italy, being 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, left commentators concerned over the potential impact of sovereign default and the resulting effect on the euro zone banking sector.

The approval by various countries of the £440bn bail out fund in September has brought temporary relief to financial markets but this does not provide a credible remedy to the scale of the Greek debt problem or the sheer magnitude of the potential needs of other countries for support.

This, coupled with 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 Poors, 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 been lower than expected, with future prospects similarly cut. Whilst not a central view, concerns of a double dip recession in some Western countries have increased. World stock markets fell in the second quarter of 2011/12 as a consequence.

5.2 UK economy

Following zero growth in the final half of 2010/11 the UK economy grew by a weaker than expected 0.2% in the first quarter of 2011/12, providing a knock on effect to future growth prospects. Growth prospects will be governed by UK consumer sentiment, which is currently subdued due to falling disposable income. Higher VAT, overhanging debt, high inflation and concerns over employment are likely to weigh heavily on consumers into the future.

Inflation remains stubbornly high, although the expectation of future falls, the external nature of the price increases (energy, oil, food etc.), and the negative impact a rate rise would have on the UK economy, is likely to stop the Monetary Policy Committee from raising the Bank Rate for some considerable time to come. An indicator of the worsening position arose from the Monetary Policy Committee minutes recently signalling a greater willingness to expand the quantitative easing programme

International investors continue to view UK government gilts as being a safe haven from the EU sovereign debt crisis. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and sent PWLB borrowing rates to low levels.

5.3 Outlook for the next six months of 2011/12

There remain huge uncertainties in economic forecasts due to the following major difficulties:

- the speed of economic recovery in the UK, US and EU;

- the likely political gridlock in the US preventing significant government fiscal action to boost growth ahead of the Presidential elections in November 2012;
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy;
- the degree to which government austerity programmes will dampen economic growth;
- the potential for more quantitative easing, and the timing of this in both the UK and US;
- the speed of recovery of banks' profitability and balance sheet imbalances;

The overall balance of risks is weighted to the downside:

- The expectations are low and modest growth in the UK to continue, with a low Bank Rate to continue for at least 12 months, coupled with a possible extension of quantitative easing. This will keep investment returns depressed.

- The expected longer run 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.

5.4 Economic Forecast

The following forecast has been provided by Sector:

| | NOW | Dec11 | Mar12 | Jun12 | Sep12 | Dec12 | Mar13 | Jun13 | Sep13 | Dec13 | Mar14 | Jun14 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Sectors Bank Rate View** | **0.50%** | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.75% | 1.00% | 1.25% | 1.50% |
| **5yr PWLB** | **2.30%** | 2.30% | 2.30% | 2.30% | 2.30% | 2.40% | 2.50% | 2.60% | 2.70% | 2.80% | 2.90% | 3.10% |
| **10yr 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% |
| **25yr 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% |
| **50yr 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% |

## 6.0 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

6.1 The Treasury Management Strategy Statement (TMSS) for 2011/12 was approved by full Council on 2nd March 2011.

## 7.0 THE COUNCIL'S CAPITAL POSITION (PRUDENTIAL INDICATORS)

7.1 As part of the Councils ongoing requirement to report to members the current capital position, the Council is required to prepare prudential indicators and report on any significant variations to those set as part of the Treasury Management Strategy. These indicators can be found in Appendix One to this report.

7.2 The Capital Financing Requirement (CFR) has changed from £113.96m to £122.37m as a result of slippage in the 2010/11 programme. This has the effect of reducing the actual CFR and the underlying need to borrow in 2010/11 and increasing it in 2011/12. The overall result remains the same and does not increase the Councils overall borrowing requirement in 2011/12.

7.3 There are no expected material changes to the capital programme as set out in the original budget for the remainder of 2011/12.

7.4 The Operational Director - Finance reports that no difficulties are envisaged for the current or future years in complying with any of the prudential indicators.

## 8.0 INVESTMENT AND BORROWING PORTFOLIO

Investments

8.1 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. 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.

8.2 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.

8.3 The Council held £52.8m of investments as at 30th September 2011 (£9.55m at 31 March 2011) and the investment portfolio yield for the first six months of the year is 1.125% against a benchmark of 3-month LIBID at 0.60%.

8.4 The Operational Director – Finance confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2011/12.

8.5 The forecast income and outturn for the first six months of 2011/12 is £0.218m when compared with a budget of £0.037m at the half year stage. This is due to the management of cash deposits around the planned delivery of the capital programme and most notably the acquisition of land for the Mersey Gateway project.

8.6 The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

New Borrowing

8.7 The Council's capital financing requirement (CFR) for 2011/12 was set at £113.96m. 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.

8.8 Due to the overall financial position and the underlying need to borrow for capital purposes, new external borrowing of £33.0m was undertaken from the PWLB / market as follows:

| Source | Value (£m) | Rate (%) | Date | Period |
|---|---|---|---|---|
| PWLB | 10,000 | 2.21 | 07/04/2011 | 18 months |
| Market | 3,000 | 1.50 | 06/04/2011 | 12 months |
| Market | 7,000 | 1.50 | 07/04/2011 | 12 months |
| Market | 8,000 | 0.85 | 14/07/2011 | 12 months |
| Market | 5,000 | 1.35 | 25/08/2011 | 24 months |
| **Total** | **33,000** | | | |

It is anticipated that further borrowing will be undertaken during this financial year to support the capital programme.

## 9.0 COUNTERPARTY LIMITS

9.1 The recent credit downgrading of many well know UK high street banks has reduced the Council's ability to select an appropriate counterparty who is not exposed to current market conditions.

9.2 The Council has scaled back its investment terms to 3 months for all counterparties who are not backed by UK Government. This will have a direct impact on the interest income it expects to receive during 2011/12. The Council's key priority is security of funds deposited in exchange for interest foregone.

9.3 As a consequence of delays in the capital programme, and in particular the Mersey Gateway project, more investments are being held with UK backed LloydsTSB and the Royal Bank of Scotland (RBS). With potential further delays likely combined with advanced borrowing where beneficial, it is recommended to increase the counterparty limits of LloydsTSB and RBS as follows:

| | Current | | Revised | |
|---|---|---|---|---|
| | <3months | >3months | <3months | >3months |
| LloydsTSB | £20million | £15million | £30million | £20million |
| RBS | £20million | £15million | £30million | £20million |

9.4 The counterparty limits will be reviewed and adjusted where appropriate in the Treasury Management Strategy 2012/13.

## 10.0 DEBT RESCHEDULING

10.1 No debt rescheduling was undertaken during the first six months of 2011/12.

## 11.0 POLICY IMPLICATIONS

11.1 None

## 12.0 OTHER IMPLICATIONS

12.1 None

## 13.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES

13.1 **Children and Young People in Halton**

None

13.2 **Employment, Learning and Skills in Halton**

None

13.3 **A Healthy Halton**

None

13.4 **A Safer Halton**

None

13.5 **Halton's Urban Renewal**

None

## 14.0 RISK ANALYSIS

14.1 The main risks with Treasury Management are security of investment and volatility of return. To combat this, the Authority operates within a clearly defined Treasury Management Policy and annual borrowing and investment strategy, which sets out the control framework

## 15.0 EQUALITY AND DIVERSITY ISSUES

15.1 There are no issues under this heading.

## 16.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972

16.1 There are no background papers under the meaning of the Act.

**APPENDIX ONE**

## HBC Treasury Management Prudential and Treasury Management Indicators 2011/12 to date

| | | | Original | Revised |
|---|---|---|---|---|
| | **Prudential Indicators** | | | |
| | Total capital expenditure | £m | 80.56 | 78.54 |
| | Capital Financing Requirement (CFR) 2010/11 | £m | 86.11 | **76.10** |
| | Capital Financing Requirement (CFR) 2011/12 | £m | 113.96 | **122.37** |
| | **Treasury Management** | | | |
| | Adopted CIPFA Code of Practice for Treasury management | | yes | yes |
| | Authorised limit for external debt | £m | 92.00 | 92.00 |
| | Operational boundary for external debt | £m | 82.00 | 82.00 |