Report to	Cabinet	**Item**
	14 January 2013	
Report of	Chief finance officer	12
Subject	Treasury Management Strategy Statement and Annual Investment Strategy : Mid-year Review Report 2012-13	

Purpose

This report sets out the Treasury Management performance for the first six months of the financial year to 30 September 2012

Recommendation

That cabinet notes the report and treasury activity and recommends to full council that it:

(1) notes the report and the treasury activity

(2) approves the revised prudential indicators.

Corporate and service priorities

The report helps to meet the corporate priority “Value for money services” and the service plan priority.

Financial implications

The report has no direct financial consequences however it does report on the performance of the council in managing its borrowing and investment resources

Ward/s: All wards

Cabinet member: Councillor Waters – Deputy leader and resources

Contact officers

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Background documents

None

Background

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 low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

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. As a consequence 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."

Introduction

4. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2011 was adopted by this council on 22 March 2011

5. The primary requirements of the Code are as follows:

    (a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the council's treasury management activities.

    (b) Creation and maintenance of Treasury Management Practices which set out the manner in which the council will seek to achieve those policies and objectives.

    (c) Receipt by the full council of an annual Treasury Management Strategy Statement (TMSS) - 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.

    (d) 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.

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

(a) An economic update:

(b) A review of the council's investment portfolio;

(c) A review of the council's borrowing strategy;

(d) A review of debt rescheduling;

(e) A review of the Treasury Management Strategy Statement and Annual Investment Strategy;

(f) The council's capital position (prudential indicators), including a review of compliance with Treasury and Prudential Limits.

Economic update

Economic performance to date

7. Economic sentiment, in respect of the 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, and that on-going negative sentiment in that area would inevitably permeate into the UK's economic performance.

8. 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 and the UK, but also in America and the Far East/China.

9. 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. Whilst inflation has fallen considerably (CPI @ 2.6% in July), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession. This means that the UK's recovery from the initial 2008 recession has been the worst and slowest of any G7 country apart from Italy (G7 = US, Japan, Germany, France, Canada, Italy and UK). It is also 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.

10. 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 addition, in June, the Bank of England and the government announced schemes to free up banking funds for business and consumers.

11. On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested in and gilt yields, prior to the ECB bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

Outlook for the next six months of 2012-13

12. The risks in economic forecasts continue unabated from the previous treasury strategy. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is hamstrung by political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required early in 2013 to address the US debt position. However, on 13 September the Fed. announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid 2015.

13. 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 (third) bail out. There is the distinct possibility that some of the northern European countries could push for the ejection of Greece from the Eurozone unless its financial prospects improve, which does not seem likely at this juncture. A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the ECB announced that it would purchase unlimited amounts of shorter term bonds of Eurozone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions (which have yet to be set) and include supervision from the International Monetary Fund. This resulted in a surge in confidence that the Eurozone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether the politicians in charge of Spain and Italy will accept such loss of sovereignty in the light of the verdicts that voters have delivered to the politicians in other peripheral countries which have accepted such supervision and austerity programmes. The Eurozone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous “solutions” to the Eurozone crisis.

14. 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. Nevertheless, concern remains that the Bank’s forecasts of a weaker and delayed robust recovery may still prove 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, meanwhile, is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

15. The overall balance of risks is, therefore, weighted to the downside:

(a) We expect low growth in the UK to continue, with Bank Rate unlikely to rise in the next 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.

(b) The expected longer run trend for PWLB borrowing rates is for them to eventually 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, tempering any increases in yield.

(c) This interest rate forecast is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Eurozone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.

Investment Portfolio

16. 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 3, 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.

17. The council held £59.5m of investments as at 30 September 2012 (£54m at 31 March 2012) and the investment portfolio yield for the first six months of the year is 1.47%.

18. The following table shows the movement in investments for the first six months of the year.

Investments £'000	**TMSS**	**Actual 31 March 2012**	**Movement**		**Actual 30 September 2012**
			Invested	**Matured**	
Long Term					
Banks		16,500	1,000	-	17,500
Local Authorities		-	3,000	-	3,000
Short term					
Banks		2,000	8,000	(2,000)	8,000
Building Societies		21,000	2,000	(11,000)	12,000
Local Authorities		14,500	29,000	(24,500)	19,000
Total	**40,000**	**54,000**	**43,000**	**(37,500)**	**59,500**

19. The council's investment return for the first six months of 2012-13 is £654,804, which is £169,595 above the amount budgeted for the period of £485,239.

20. The chief financial officer confirms that all investment transactions undertaken during the first six months of 2012-13 were within the approved limits in the Annual Investment Strategy.

21. The current investment counterparty criteria selection the TMSS, as amended by council on 25 July 2012, is meeting the requirement of the treasury management function.

Borrowing strategy

22. The council's capital financing requirement (CFR) for 2012/13 is £236. 902m 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. The table below shows the council has borrowings of £243.097 and has utilised cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

23. Appendix 1 shows the reduction in interest rates during the six months, across all maturity bands. Appendix 2 sets out predicted interest rates going forward. However, due to the overall financial position no new external borrowing was undertaken. No further borrowing is expected to be undertaken during the remainder of this financial year.

24. The council's debt position is shown in the following table:

Borrowing £'000	**TMSS**	**Actual 31 March and 30 September 2012**
Long Term		
Public Works Loan Board		218,917
Money Market		5,295
3% Stock (perpetually irredeemable)		499
corporate bonds and external mortgages		272
Short Term		
Money Market		18,114
Total	**234,367**	**243,097**

Debt rescheduling

25. No debt rescheduling was undertaken during the first six months of 2012-13.

Treasury Management Strategy Statement and Annual Investment Strategy update

26. The TMSS for 2012/13 was approved by this council on 20 March 2012, with a subsequent amendment being approved on 25 July 2012. There are no proposed policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

Prudential Indicator 2012/13 £'000	Original per TMSS	Revised
Authorised Limit	267,604	245,857
Operational Boundary	247,604	225,857
Capital Financing Requirement	232,291	236,902

The council's capital position (Prudential Indicators) including a review of compliance with Treasury and Prudential Limits

27. This part of the report is structured as follows:

(a) the council's capital expenditure plans;

(b) how these plans are being financed;

(c) the impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow;

(d) Compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

28. This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the budget.

Capital Expenditure by Service £'000	2012/13 Original Estimate	2012/13 Revised Estimate
Non-HRA	8,395	7,631
HRA	30,275	32,321
Total	**38,670**	**39,952**

Changes to the financing of the Capital Programme

29. The table below 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.

Capital Expenditure £'000	2012/13 Original Estimate	2012/13 Revised Estimate
Total spend	**38,670**	**39,952**
Financed by:		
Capital receipts	13,691	5,652
Capital grants	1,889	844
Capital reserves	21,187	31,877
Revenue	1,327	142
Total financing	**38,094**	**38,525**
Borrowing need	**576**	**1,427**

Changes to the Prudential Indicators for the capital financing requirement, external debt and the operational boundary

30. The tables below show the CFR, which is the underlying external need to incur borrowing for a capital purpose, and the expected debt position over the period, termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement £'000	**2012-13 Original Estimate**	**2012-13 Revised Estimate**
CFR – non housing	34,649	38,614
CFR – housing	197,642	198,288
Total CFR	232,291	236,902
Net movement in CFR		**4,611**

31. It is anticipated that the original forecast Capital Financing Requirement will be exceeded to the value of £4,611k which is due to an under-estimation of the CFR at 31 March 2012 and 31 March 2013 and the unforeseen repayment of transferred debt by Norfolk County Council.

Prudential Indicator – External Debt / the Operational Boundary £'000	**2012/13 Original Estimate**	**2012/13 Revised Estimate**
Borrowing	234,367	224,427
Other long term liabilities*	430	1,431
Total debt 31 March	**234,797**	**225,858**

** On balance sheet finance leases*

32. The Operational Boundary current position has changed from the original forecast due to the erroneous omission of finance lease creditor from other long term liabilities and accrual of interest on two external loans. The revised estimate includes changes due to the exclusion of two loans scheduled for repayment in February 2013 and the PFI creditors erroneous included and changes to the long term creditor for finance leases.

Limits to borrowing activity

33. 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.

Borrowing limit £'000	**2012/13 Original Estimate**	**2012/13 Revised Estimate**
Gross borrowing	234,367	224,427
Plus other long term liabilities*	430	1,431
Less investments	40,000	50,000
Net borrowing	**194,797**	**175,858**
CFR* (year end position)	**232,291**	**236,902**

** Includes on balance sheet finance leases*

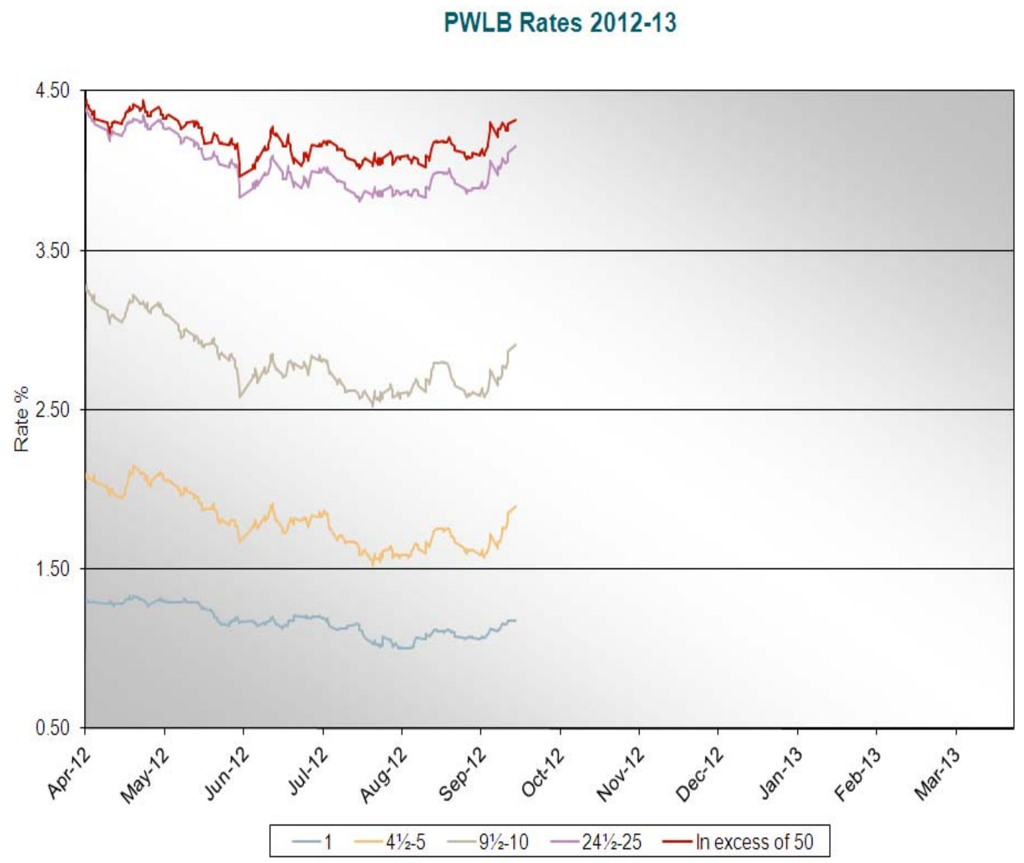
34. The chief finance officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

35. 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. The revised Authorised Limit includes due to the exclusion of two loans scheduled for repayment in February 2013 and the PFI creditors erroneous included in the original and changes to the long term creditor for finance leases.

Authorised limit for external debt £'000	**2012-13 Original Indicator**	**2012-13 Revised Indicator**
Borrowing	262,035	244,427
Other long term liabilities*	5,569	1,431
Total	**267,604**	**245,858**

** Includes on balance sheet finance leases*

Appendix 1: Movement in PWLB rates for the first six months of the year (to 10.9.12)



Appendix 2: Treasury Management Adviser's (Sector's) interest rate forecast

	17.9.12 actual		**Dec-12**	**Mar-13**	**Jun-13**	**Sep-13**	**Dec-13**	**Mar-14**	**Jun-14**	**Sep-14**	**Dec-14**	**Mar-15**
BANK RATE	0.50		0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
3m LIBID	0.55		0.60	0.60	0.60	0.60	0.60	0.60	0.70	0.90	1.10	1.40
6m LIBID	0.85		0.85	0.85	0.85	0.85	0.85	1.00	1.10	1.30	1.50	1.80
12m LIBID	1.30		1.30	1.30	1.30	1.40	1.50	1.70	1.90	2.10	2.30	2.60
5yr PWLB	1.89		1.50	1.50	1.50	1.60	1.70	1.80	1.90	2.00	2.10	2.30
10yr PWLB	2.91		2.50	2.50	2.50	2.60	2.70	2.80	2.90	3.00	3.20	3.30
25yr PWLB	4.15		3.70	3.70	3.70	3.80	3.80	3.90	4.00	4.10	4.20	4.30
50yr PWLB	4.32		3.90	3.90	3.90	4.00	4.00	4.10	4.20	4.30	4.40	4.50

The above Sector forecasts for PWLB rates incorporate the introduction of the **PWLB certainty rate** in November 2012 which will reduce PWLB borrowing rates by 0.20% for most local authorities. In order to compare the forecast columns, the actual PWLB rates on 17.9.12 should therefore to be reduced by 20bps.

Integrated impact assessment

NORWICH City Council

Report author to complete	
Committee:	Cabinet
Committee date:	14 January 2013
Head of service:	Caroline Ryba, chief finance officer
Report subject:	Half year treasury management report
Date assessed:	5 January 2013
Description:	

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	The report has no direct financial consequences however it does report on the performance of the Council in managing its borrowing and investment resources
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	

	Impact			
Equality and diversity (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☒	☐	☐	

Recommendations from impact assessment
Positive
Negative
Neutral
Issues