TO: Governance and Audit Committee
29 SEPTEMBER 2011

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY – MID-YEAR REVIEW REPORT 2011/12
Borough Treasurer

1 PURPOSE OF REPORT

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

1.2 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 longer term cash flow planning needs 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.

1.3 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. "

1.4 The Local Government Act 2003 requires a local authority to "have regard to" guidance issued by, or specified by, the Secretary of State. As such, the Council is required to have regard to the Prudential Code and the Code of Practice on Treasury Management in the Public Sector, both issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

1.5 One of the primary requirements of the code is for the receipt by Full Council of a Mid-Year Review Report of the Treasury Management activities of the authority and for the scrutiny of the treasury management strategy by a delegated body.

2 RECOMMENDATION(S)

2.1 That the Committee consider and review the Mid-Year Review Report and share the report with members of the Full Council.

3 REASONS FOR RECOMMENDATION(S)

3.1 A primary requirement of the CIPFA Code of Practice on Treasury Management is to provide Full Council with a Mid-Year Review Report on its Treasury Management activities and for the delegation by the Council to a scrutiny body for the review of the Treasury Management Strategy. This report, by being reviewed by the Governance and Audit Committee and shared with members of Full Council, fulfils this requirement

4 ALTERNATIVE OPTIONS CONSIDERED

4.1 None.

5 SUPPORTING INFORMATION

5.1 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 and Annual Investment Strategy
- The Council's capital expenditure (prudential indicators)
- A review of the Council's investment portfolio for 2011/1;
- A review of compliance with Treasury and Prudential Limits for 2011/12

5.2 There have been no changes to the Council's Treasury Strategies during the year to date.

Economic Update

5.3 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 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 resulting effect on the Euro zone banking sector.

5.4 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.

5.5 Growth prospects in the US, UK and the Euro zone have been lower than expected, with future prospects similarly cut. World stock markets fell in the second quarter of 2011/12 as a consequence.

5.6 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 sentiments, which are 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.

5.7 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 will have on the UK economy, is likely to stop the Monetary Policy Committee from raising the Bank Rate for some time to come.

5.8 International investors continue to view UK government gilts as being a safe haven, bolstered by both the EU sovereign debt concerns and the US difficulties. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and sent PWLB borrowing rates to low levels.

5.9 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 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 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
- Low and modest growth in the UK is expected to continue, with a low Bank Rate to continue for at least 12 months. This will have a subduing effect on investment returns. The latest forecast as provided by the Council's Treasury Management advisers is shown below

	Now	**Dec 11**	**Mar 12**	**Jun 12**	**Sep 12**	**Dec 12**	**Mar 13**
Bank Rate	0.5%	0.5%	0.5%	0.5%	0.5%	0.75%	1.0%

Treasury Management Strategy Statement Review

5.10 The Treasury Management Strategy Statement (TMSS) for 2011/12 was approved by the Council on 2nd March 2011. There are no policy changes to the TMSS, the details in this report update the position in the light of the updated economic position.

Capital Expenditure

5.11 The table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget. The Council is on target to achieve the original forecast Capital Financing Requirement (reflecting the underlying need to borrow for a capital purpose) and no external borrowing is forecast for the year.

Department	**Approved Budget For 2011/12 £'000s**	**Cash Budget 2011/12 £'000s**	**Funding Required 2011/12 £'000s**	**Cash Budget 2012/13 £'000s**	**(Under) /Over Spend £'000s**
Council Wide	4,670.5	4,670.5	4,670.5	0.0	0.0
Corporate Services	744.3	568.5	568.5	175.8	0.0
Children, Young People and Learning	22,380.6	15,065.5	15,065.5	7,315.1	0.0
Adult Social Care and Health	943.0	943.0	943.0	0.0	0.0
Environment, Culture and Communities	17,530.0	17,530.0	17,530.0	0.0	0.0
TOTAL CAPITAL PROGRAMME	46,268.4	38,777.5	38,777.5	7,490.9	0.0

The large carry-forward within CYPL relates to significant school refurbishments that straddle more than one financial year including the rebuild of Garth Hill.

5.12 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 above, it is a very difficult investment market. Yields are very low, in line with the 0.5% Bank Rate, and the continuing Euro zone sovereign debt crisis prompts a low risk strategy. Within this risk adverse environment investment returns are likely to remain low.

Review of Investment Portfolio 2011/12

5.13 The Council held £46.2m of investments as at 30 August 2011 (£34.9m at 31 March 2011) and the investment portfolio yield for the first six months of the year is 0.78% against a benchmark (Local Authority 7-Day Rate) of 0.45%.

5.14 The 2011/12 interest budget assumed that an average interest rate of 0.9% would be earned on the Council's investment portfolio. Taken together with the income generated by pre-funding the 2011/12 pension fund contribution the interest budget was estimated to be £402,000. The Bank Rate (set monthly by the Bank of England) has remained at an historical low of 0.5% and, given the current weaknesses in both the UK and the Global economy, is likely to remain at this level for some months to come.

5.15 The impact of this is likely to pressure the rate of return achievable by the Council in the current year, however by slightly extending maturities on a proportion of its investments (to a maximum of 9 months and in-line with the Council's approved investment strategy) the projected return is likely to be approximately 0.75%. However the small reduction in investment income attributable to this lower interest rate will be more than offset by the higher cash balances that have been experienced in the first 6 months of the year generating an additional £40,000. Furthermore the additional income from the pre-funding of the pension fund contribution was conservatively estimated to be £200,000. Taking into account payments so far this year an additional £60,000 contribution can now be reflected in the estimated out-turn.

5.16 As such additional income of £100,000 can be confidently projected for the current financial year. However, given that the latest consensus amongst independent economic commentators on UK interest rates is for an increase to be delayed until Dec 2012 at the earliest, there will undoubtedly be further pressure on the 2012/13 interest budget.

Compliance with Treasury and Prudential Limits for 2011/12

5.17 The Borough Treasurer can confirm that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2011/12 and no changes to these limits are proposed in 2011/12.

5.18 The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function and no changes are, therefore, recommended.

<u>Background Papers</u>
None

<u>Contact for further information</u>
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