BRECKLAND DISTRICT COUNCIL

Report of Mark Finch - Assistant Director of Finance

To: Audit Committee 25th November 2011
(Author: Margaret Bailey, Senior Accountant, Capital and Treasury)

Subject: Treasury Management Mid Year Report

Purpose of Report
This report requests Audit Committee to note the update on the Treasury Management Strategy, Policy and Prudential Indicators.

Note: In preparing this report, due regard has been had to equality of opportunity, human rights, prevention of crime and disorder, environmental and risk management considerations as appropriate. Relevant officers have been consulted in relation to any legal, financial or human resources implications and comments received are reflected in the report.

Recommendations
It is recommended that the Committee: 1. Note the report and the information on the treasury activity.

1.0 Introduction

1.1 Revisions to the regulatory framework of treasury management during 2009 introduced a requirement that the Council receive a mid year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously. This report meets that requirement. It also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The Treasury Strategy, Policy and Prudential Indicators for 2011/12 were approved at Audit Committee on 14th January 2011.

1.2 The underlying purpose of the report supports the objective in the revised CIPFA Code of Practice on Treasury Management and the CLG Investment Guidance. These state that Members receive and adequately scrutinise the treasury management service.

1.3 The underlying economic environment remains difficult for the Council, foremost are the concerns over investment counterparty risk. This background encourages the Council to continue maintaining investments short term and with high quality counterparties. This is supported by the Council's Treasury Advisors who in August advised on a restriction of investments to a maximum of 3 months with a small number of exceptions. The downside of such a policy is that investment returns remain low.

1.4 The report is structured to highlight the key changes to the Council's capital activity (the prudential indicators {PIs}), the economic outlook and the actual and proposed treasury management activity (borrowing and investment). Appendix A

1.5 The Assistant Director of Finance can report that the basis of the treasury management strategy, the investment strategy and the PIs are not materially changed. There are no recommended changes to any of the documents.

2.0 Summary of Key Changes

2.1 Changes to TMP 5 to reflect new staff structures in 2011/12 were approved by Audit Committee on 30th September. There are no further changes affecting the 2011/12 to report.

2.2 The Council's bank contract is due to expire on 31/3/2012. A further competition exercise under the terms of ESPO framework 384 Banking Services was undertaken in September/October. Whilst only the Co-op bank responded, this was fully evaluated by ESPO and Officers and the recommendation to enter into a further contract with Co-op for four years with the option to extend by a further two years at the discretion of the Council was approved under delegated powers on the 24th October 2011. The new contract offered budget savings of approximately £11,000 over the three year period 2012/13 – 2014/15 (based on previously forecast costs). However, the risk of cost increases was noted as bank fees are based on throughput.

3.0 Options

3.1 Approve the recommendations

3.2 Not approve the recommendations

4.0 Reasons for Recommendations

4.1 To comply with the Local Government Act 2003 and to safeguard the Council's financial assets

5.0 Risk and Financial Implications

5.1 Risk

5.1.1 I have completed the Risk Management questionnaire and can confirm that risk has been given careful consideration. Risk is addressed in TMP1 within the Treasury Management Policy Statement 2011/12.

5.2 Financial

5.2.1 None

6.0 Legal Implications

6.1 To comply with the Local Government Act 2003.

7.0 Other Implications

7.1	a)	Equalities	No
	b)	Section 17, Crime & Disorder Act 1998	No
	c)	Section 40, Natural Environment & Rural Communities Act 2006	No
	d)	Human Resources	No
	e)	Human Rights	No
	f)	Other: [e.g. Children's Act 2004]	No

8.0 Alignment to Council priorities

8.1 This report is of a regulatory nature and therefore does not fall into the Council priorities.

9.0 Ward/Community Affected

9.1 N/A

Lead Contact Officer
Name/Post: Margaret Bailey
Telephone Number: 01362 656218
Email: Margaret.bailey@breckland.gov.uk

Appendices attached to this report:
Appendix A - Prudential indicators
Appendix B – Investment strategy 2011/12 – 2013/14

Prudential Indicators

1.0 Key Prudential Indicators

1.1 This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the PIs and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

2.0 Capital Expenditure (PI)

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

Capital Expenditure by Portfolio	2011/12 Original Estimate	Current spend @ 30/09/2011	2011/12 Revised Estimate *
Place and Governance	220,683	34,691	220,683
Commissioning	2,972,491	1,090,129	3,432,190
Total	3,193,174	1,124,820	3,652,873

** The revised estimate is NOT the approved change but the forecast outturn being presented to Council in January 2012 for approval.*

3.0 Impact of Capital Expenditure Plans

3.1 Changes to the Financing of the Capital Programme

3.2 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.

3.3 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). The Council's current CFR for borrowing purposes remains nil.

Capital Expenditure	2011/12 Original Estimate	2011/12 Revised Estimate *
Supported	3,193,174	3,652,873
Unsupported	-	
Total spend	3,193,174	3,652,873
Financed by:		
Capital receipts	2,386,633	2,997,302
Capital grants	713,312	562,342
Capital Reserves	93,229	93,229
Total Financing	3,193,174	3,652,873
Borrowing Need	**Nil**	**Nil**

** The revised estimate is NOT the approved change but the forecast outturn being presented to Council in January 2012 for approval.*

4.0 Changes to Performance Indicators (PI's)

Capital Financing Requirement (CFR), External Debt and the Operational Boundary

4.1 **Prudential Indicator – Capital Financing Requirement (CFR)**
The table shows the CFR, which is the underlying external need to borrow for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

4.2 The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. The Council has financed it's capital expenditure are on target to achieve the original forecast Capital Financing Requirement as shown below

Prudential Indicator – External Debt / the Operational Boundary

	2011/12 Original Estimate	**Current Position**	**2011/12 Revised Estimate**
Prudential Indicator – Capital Financing Requirement			
Total CFR	0		0
Net movement in CFR	0		0
Prudential Indicator – External Debt / the Operational Boundary			
Total Debt 31 March 2012	0		0

Note
The Leisure PFI is now on balance sheet and increases the CFR. This is a long term liability but it does not affect the Council's debt position, which remains nil, as the debt facility embedded in the PFI will be repaid over the life of the scheme. As a consequence it has been omitted from the table.

The Prudential Indicator demonstrates that in 11/12 there is no requirement to borrow. However, please refer to the budget report (capital strategy) being presented to this same committee meeting which gives more detail on the current capital programme and forecast CFR. The table below is an extract from the capital strategy and shows that if the recommended budget is approved, there are £2.2m capital resources available before there is a need to borrow (unless further receipts are generated).

Summary of Estimated Capital Resources (as per budget report – not yet approved)

Resources	2011/12 (£'000s)	2012/13 (£'000s)	2013/14 (£'000s)	2014/15 (£'000s)
Opening Balance	(2,881)	(693)	2,208	5,857
Movement in year	2,188	2,901	3,649	1,035
CFR as per Prudential Code	(693)	2,208	5,857	6,892
PFI Liability	(9,660)	(9,492)	(9,315)	(9,129)
Underlying Borrowing requirement	**(10,353)**	**(7,284)**	**(3,458)**	**(2,238)**

5.0 Limits to Borrowing Activity

5.1 The first key control over the treasury activity is a PI 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 2011/12 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.

	2011/12 Original Estimate £000	2011/12 Revised Estimate * £000
Gross Borrowing	0	0
Plus Other Long Term liabilities*	9,660	9,660
Less Investments	21,000	21,000
Net Borrowing	(21,000)	(21,000)
CFR* (year end position)	0	0

* The Leisure PFI is now on balance sheet and increases the CFR. This is a long term liability but it does not affect the Council's debt position, which remains nil, as the debt facility embedded in the PFI will be repaid over the life of the scheme.

5.2 The Assistant Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this PI. However, approximately £8m of the investment balance is dependent on Icelandic balances being repaid as detailed in the 2010/11 final accounts.

5.3 A further PI 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.

Authorised limit for external debt	2011/12 Original Indicator £000	Current Position £000	2011/12 Revised Indicator £000
Borrowing	1,000	1,000	1,000
Other long term liabilities*	9,660	9,660	9,660
Total	10,660	10,660	10,660

* The Leisure PFI is now on balance sheet and shown as a long term liability, and as a consequence the Authorised Limit has been revised upwards. This does not alter the underlying finances of the Council, but ensures current activity is within the required limits.

6.0 Economic Update (provided by sector 07/10/11)

6.1 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 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.

6.2 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 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 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.

6.3 UK economy. 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, 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.

6.4 The announcement by the MPC on 6 October of a second round of quantitative easing of £75bn emphasised how seriously the MPC now views recession as being a much bigger concern than inflation. Although inflation remains stubbornly high, the MPC's expectation of future falls resulting in an undershoot of its 2% target opened the way for this new round of QE.

6.5 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.

7.0 Outlook for the next six months of 2011/12 (provided by Sector 07/10/11)

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

- the increase in risk that the UK, US and EU could fall into recession
- 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 economies
- the degree to which government austerity programmes will dampen economic growth;
- the potential for further quantitative easing, and the timing of this in both the UK and US
- the speed of recovery of banks' profitability and balance sheet imbalances and the risk of substantial losses being incurred on EU sovereign debt

The overall balance of risks is weighted to the downside:

- We expect low growth in the UK to continue, with a low Bank Rate to continue for at least 24 months, coupled with a possible further 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.

Sector's interest rate forecast

	NOW	Dec-11	**Mar-12**	Jun-12	Sep-12	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	0.75	1.00	**1.25**	1.50	2.00	2.25	**2.50**
3 month 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	2.40	**2.60**
6 month 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	2.70	**2.90**
12 month 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	3.20	**3.30**
5 yr 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	3.30	3.50	**3.70**
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	4.60	**4.80**
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	5.10	**5.20**
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	5.20	**5.30**

Appendix B

Investment Strategy 2011/12 – 2013/14

Key Objectives - The objectives of the Council's investment strategy are the safeguarding of the re-payment of the principal and interest of its investments on time – the investment return being a secondary objective. Following on from the economic background above, the current investment climate has one over-riding risk consideration, that of counterparty risk. As a result of these underlying concerns officers continue to implement an operational investment strategy which tightens the controls already in place in the approved investment strategy.

Current Investment Position – Excluding Icelandic balances, the Council held £26,789,212 of funds at 30/09/2011, and the constituent parts of the investment position are:

Sector	**Up to 1 year**
Banks UK	20,000,000
MMFs	6,789,212
Total	26,789,212

The revised budget position for investment income is:

Interest Receivable	**2011/12 Original Estimate**	**2011/12 Revised Estimate**
Total Income	528,420	658,042

Interest receivable is affected by timing of payments in and out, particularly the capital programme and cash flowing of projects. Interest is currently forecast to be above budget but interest achieved may still change.

Risk Benchmarking – Performance against discrete Security, Liquidity and Yield benchmarks are all reported on. There have been no changes to benchmarks and the Assistant Director of Finance can report that the investment portfolio was maintained within this overall benchmark during this year to date.

Note: The benchmarks are an average risk of default measure, and would not constitute an expectation of loss against a particular investment. They benchmarks are embodied in the criteria for selecting cash investment counterparties and these are monitored and reported to Members. As this data is collated, trends and analysis are collected and reported.

A summary of 11/12 risk reporting as at 30th September 2011 is shown below:

	Target	Actual	variance
Security			
Investments maturing less than 1 yr	0.060%	0.006%	0.054%
Weighted Average Life	n/a	78.08 days	n/a
Liquidity			
Instant Access cash	5,000,000	9,462,563	4,462,563
Bank Overdraft	-	-	-
Yield			
3 month LIBID	0.79%	1.15%	(0.36%)

Revisions to the Investment Strategy
There are no proposed changes to counterparty criteria. Risks and issues have been discussed throughout the report and will be monitored and reported as appropriate**.**

Treasury Management Indicators

Actual and estimates of the ratio of financing costs to net revenue stream – This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream. We are on target to achieve the original forecast for ratio of financing costs to net revenue.

Treasury Management Prudential Indicators

Upper Limits On Variable Rate Exposure – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.

Upper Limits On Fixed Rate Exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

Prudential indicator limits based on debt net of investments

Total Principal Funds Invested – These limits are set to reduce the need for early sale of an investment, and show limits to be placed on investments with final maturities beyond each year-end.

The table below is the original indicator set and there are no changes to report

£m	2011/12	2012/13	2013/14
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	0	0	0
Limits on variable interest rates based on net debt	0	0	0
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£11m	£5m	£5m