

28th NOVEMBER 2012**REPORT OF THE PORTFOLIO HOLDER FOR CORE SERVICES AND ASSETS****TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL
INVESTMENT STRATEGY MID
YEAR REVIEW REPORT 2012/13****EXEMPT INFORMATION**

None

PURPOSE

To present to Members the Mid-year review of the Treasury Management Strategy Statement and Annual Investment Strategy;

RECOMMENDATIONS

That Cabinet recommends that Council:

- 1. Accept the Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report 2012/13;**
- 2. Formally adopt the CIPFA Code of Practice as revised in November 2011.**

EXECUTIVE SUMMARY

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 2012/13;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's Capital Position (Prudential Indicators);
- A review of the Council's investment portfolio for 2012/13;
- A review of the Council's borrowing strategy for 2012/13;
- A review of any debt rescheduling undertaken during 2012/13;
- Icelandic Banking Situation;
- A review of compliance with Treasury and Prudential Limits for 2012/13.

The main issues for Members to note are:

1. The Council has complied with the professional codes, statutes and guidance.
2. There are no issues to report regarding non-compliance with the approved prudential indicators.

3. The investment portfolio yield for the first six months of the year is 1.12% compared to the 3 Month LIBID benchmark rate of 0.73%. This excludes all investments currently classified as 'At Risk' in the former Icelandic Banking institutions.

The aim of this report is to inform Members of the treasury and investment management issues to enable all Members to have ownership and understanding when making decisions on Treasury Management matters. In order to facilitate this training on Treasury Management issues has been delivered for Members in February and October 2010 and September of last year.

RESOURCE IMPLICATIONS

All financial resource implications are detailed in the body of this report which links to the Council's Medium Term Financial Strategy.

There are no staffing implications arising from the report.

LEGAL/RISK IMPLICATIONS BACKGROUND

Risk is inherent in Treasury Management and as such a risk based approach has been adopted throughout the report with regard to Treasury Management processes.

The Treasury Strategy has been the subject of an Equalities Impact Assessment.

SUSTAINABILITY IMPLICATIONS

None

1 BACKGROUND INFORMATION

The Chartered Institute of Public Finance and Accountancy (CIPFA) issued the revised Code of Practice for Treasury Management in November 2011, following consultation with Local Authorities during that summer. The revised Code suggests that members should be informed of Treasury Management activities at least twice a year, but preferably quarterly. This is the second monitoring report for 2012/13 presented to Members this year and therefore ensures this Council is embracing Best Practice in accordance with CIPFA's revised Code of Practice. Cabinet also receive regular monitoring reports as part of the quarterly healthcheck on Treasury Management activities and risks.

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.

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.

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. ”

2 Introduction

The Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (November 2009) was adopted by this Council on 22nd February 2011. The code was revised in November 2011 following developments resulting from the Localism Act 2011, including HRA finance reform and General Power of Competence. The Treasury team have been working to the revised code and ask members to formally adopt it.

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 Audit and Governance Committee.

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 2012/13;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council’s Capital Position (Prudential Indicators APPENDIX 1);
- A review of the Council’s investment portfolio for 2012/13;
- A review of the Council’s borrowing strategy for 2012/13;
- A review of any debt rescheduling undertaken during 2012/13;
- Icelandic Banking Situation;
- A review of compliance with Treasury and Prudential Limits for 2012/13.

3 Economic update

3.1 Economic performance to date

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.

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.

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) despite a blip in October, 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.

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.

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.

3.2 Outlook for the next six months of 2012/13

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 recent result of 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.

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.

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.

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

- 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.
- 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.
- 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.

3.3 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. The actual PWLB rates on 17.9.12 ought therefore to be reduced by 20bps to provide a true comparison to the forecasts.*

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2012/13 was approved by Council on 28th February 2012.

There are no 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.

5 The Council's Capital Position (Prudential Indicators)

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 prudential indicators and the underlying need to borrow;
- Compliance with the limits in place for borrowing activity; and
- A summary of Prudential Indicators can be found at **APPENDIX 1**.

5.1 Prudential Indicator for Capital Expenditure

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	2012/13 Original Programme £m	Budget B'fwd from 2011/12 £m	2012/13 Budget £m	Actual Spend @ Period 6 £m	2012/13 Projected Spend £m
General Fund	1.846	1.498	3.344	0.551	2.410
HRA	7.816	0.004	7.820	0.347	7.570
Total	9.662	1.502	11.164	0.898	9.980

5.2 Changes to the Financing of the Capital Programme

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. Any borrowing element of the table increases the underlying indebtedness of the Council by way of the 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	2012/13 Estimate £m	2012/13 Revised Estimate £m
Supported	0	0
Unsupported	11.164	9.980
Total spend	11.164	9.980
Financed by:		
Capital receipts	1.088	0.591
Capital grants	1.224	1.367
Capital reserves	1.388	0.833
Revenue	7.464	7.189
Total financing	11.164	9.980
Borrowing need	0	0

5.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

The table shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period. This is termed the Operational Boundary.

5.3.1 Prudential Indicator – Capital Financing Requirement

The original forecast Capital Finance Requirement of £68.475m has changed to £69.588m. This is due to the reduced level of principal in respect of repayments received from the Icelandic Banks.

5.3.2 Prudential Indicator – External Debt / the Operational Boundary

	2012/13 Original Estimate £m	Current Position £m	2012/13 Revised Estimate £m
Prudential Indicator – CFR			
CFR – Non Housing	0.412	1.525	1.525
CFR – Housing	68.063	68.063	68.063
Total CFR	68.475	69.588	69.588
Net movement in CFR	(0.017)	(0.080)	(0.080)
Prudential Indicator – External Debt / the Operational Boundary			
Borrowing	72.268	72.268	72.268
Other long term liabilities	0	0	0
Total debt 31 March	72.268	72.268	72.268

5.4 Limits to Borrowing Activity

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.

	2012/13 Original Estimate £m	Current Position £m	2012/13 Revised Estimate £m
Gross borrowing	65.060	65.060	65.060
Plus other long term liabilities	0	0	0
Less investments	(11.612)	(23.085)	(11.612)
Net borrowing	53.448	41.975	53.448
CFR (year end position)	68.475	69.588	69.588

The Corporate Director Resources reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

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.

Authorised limit for external debt	2012/13 Original Indicator £m	Current Position £m	2012/13 Revised Indicator £m
Borrowing	89.112	89.112	89.112
Other long term liabilities	3.000	3.000	3.000
Total	92.112	92.112	92.112

6 Investment Portfolio 2011/12

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 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.

The Council held £23.085m of investments as at 30 September 2012 (£15.699m at 31 March 2012) and the investment portfolio yield for the first six months of the year is 1.12% against a benchmark of the 3 months LIBID of 0.73%. A full list of investments held as at 30th September 2012 is in **APPENDIX 2**.

The Executive Director Corporate Services confirms that the approved limits within the Annual Investment Strategy were breached once during the first six months of 2012/13 due to a deposit payment instruction not being actioned. This resulted in the Authority exceeding the approved £2m maximum balance limit with our bankers, the Co-op, by £924k for one day.

The Council's budgeted investment return for 2012/13 is £220k, and performance for the year to date is £9k above budget.

CIPFA Benchmarking Club

The Council is a member of the CIPFA Treasury Management Benchmarking Club which is a means to assess our performance over the year against other members (38 Authorities).

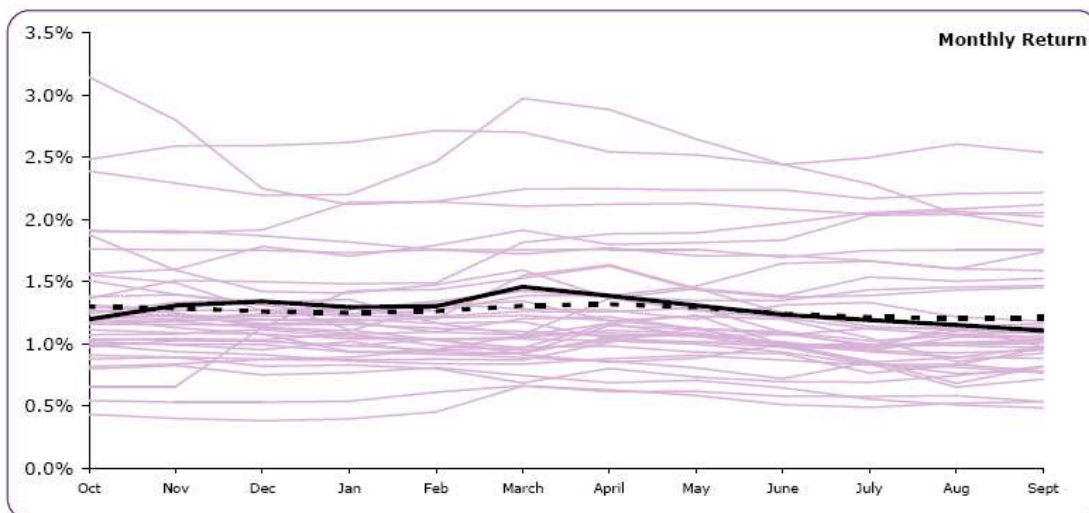
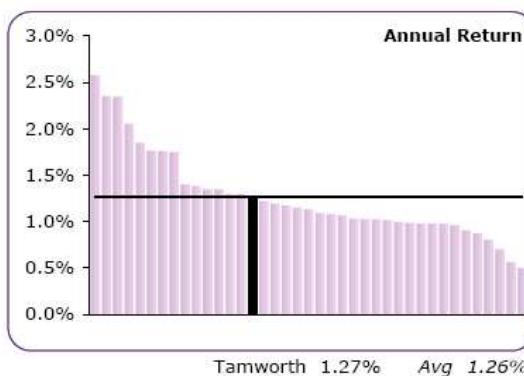
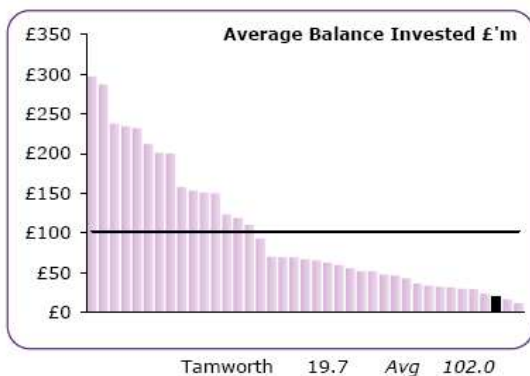
Our average return for In House Investments for the period October 2011 to September 2012 was 1.27% compared to the group average of 1.26% (information from CIPFA Benchmarking Draft Report Q2 2012/13) excluding the impaired investments in Icelandic banks. This is considered to be a good result in light of the current financial climate, our lower levels of deposits/funds and shorter investment time-lines due to Banking sector uncertainty, when compared to other Authorities.

This can be analysed further into the following categories:

Excluding Impaired Investments	Average Balance Invested £ m		Average Rates Received %	
	Tamworth Borough Council	CIPFA Benchmarking Club	Tamworth Borough Council	CIPFA Benchmarking Club
Investments < 365 days Managed in-house	10.1	42.6	1.76	1.39
Investments > 365 days Managed in-house	0	21.0	1.91	2.41
Callable & Structured Deposits	0	14.6	0	2.37
Call Accounts	4.3	23.0	0.87	0.85
Money Market Funds	5.2	19.5	0.64	0.67
DAMDF (Govt Debt Management Office)	0	3.8	0.25	0.25
CD's Gilts & Bonds	0	16.5	0	1.71
Average of All Investments Managed in-house	19.7	102.0	1.27	1.26

The data above and graphs below display that despite the Council being a small investor in the markets, performance is marginally better when compared with other members of the benchmarking club and affirms our 'low appetite for risk' in the continuing unsettled markets.

COMBINED IN-HOUSE INVESTMENTS (excluding impaired investments)



Monthly Return (Oct 11 - Sept 12)													
	Oct	Nov	Dec	Jan	Feb	March	April	May	June	July	Aug	Sept	Year
Av Bal £'m	19.00	18.21	18.23	19.08	17.12	15.16	18.08	20.18	21.93	22.11	23.04	24.07	19.69
Earned £'k	19.3	19.6	20.8	21.0	17.7	18.8	20.6	22.5	22.3	22.4	22.6	21.9	249.4
% Return	1.20%	1.31%	1.34%	1.30%	1.30%	1.46%	1.39%	1.31%	1.24%	1.19%	1.15%	1.11%	1.27%
Average	1.30%	1.29%	1.26%	1.25%	1.26%	1.31%	1.32%	1.29%	1.24%	1.22%	1.20%	1.21%	1.26%
Margin	-0.10%	0.02%	0.08%	0.04%	0.04%	0.15%	0.07%	0.02%	-0.01%	-0.02%	-0.05%	-0.11%	

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the Treasury Management function.

7 Borrowing

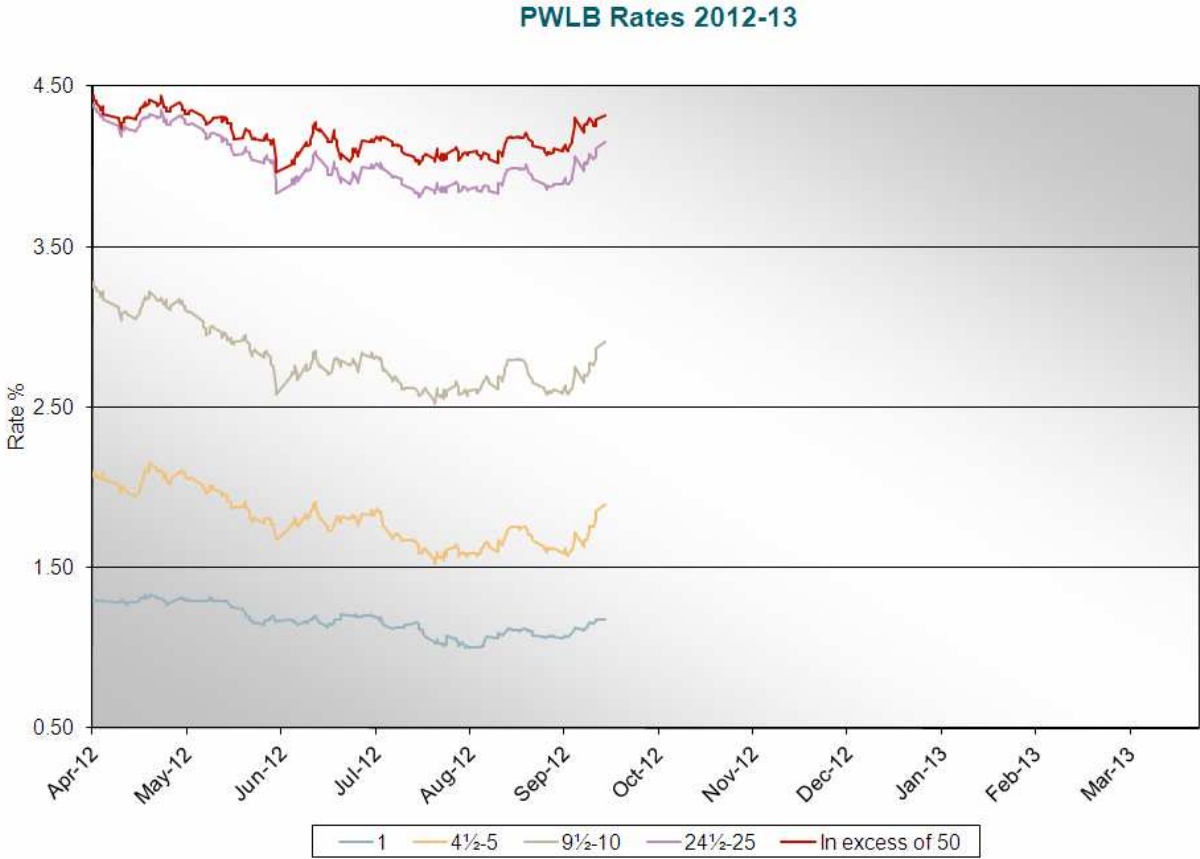
The Council's capital financing requirement (CFR) for 2012/13 is £69.588m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 5.4 shows the Council has borrowings of £65.060m and has utilised £4.528m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

No new external borrowing was undertaken from the PWLB or the money markets in the first half of the year.

As outlined below, the general trend has been a reduction in interest rates during the six months, across all maturity bands.

It is anticipated that further borrowing will not be undertaken during this financial year.

The graph and table below show the movement in PWLB rates for the first six months of the year (to 10.9.12):



	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	GBR 1mth
High	1.330%	1.400%	1.690%	1.910%	2.150%	3.250%	4.370%	4.430%	1.500%
Dates	20/04/2012	20/04/2012	20/04/2012	20/04/2012	20/04/2012	02/04/2012	02/04/2012	24/04/2012	18/04/2012
Low	1.000%	1.030%	1.170%	1.320%	1.520%	2.520%	3.810%	3.960%	1.450%
Dates	02/08/2012	02/08/2012	23/07/2012	23/07/2012	23/07/2012	23/07/2012	18/07/2012	01/06/2012	01/08/2012
Average	1.171%	1.211%	1.410%	1.592%	1.801%	2.816%	4.032%	4.190%	1.478%
Spread	0.330%	0.370%	0.520%	0.590%	0.630%	0.730%	0.560%	0.470%	0.050%

8 Debt Rescheduling

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates. No debt rescheduling was undertaken during the first six months of 2012/13.

9 Icelandic Banks Update

Appendix 3 contains details of the situation with Icelandic investments as at 30th September 2012.

Expectations of future receipts and timeframes based on current information regarding each bank are given below;

- Glitnir

On 15th March 2012, the Council received £2.554m being the majority of our deposits with the bank, the balance of our approved claim, equating to £587k, is being held in an ESCROW account in Iceland. The release of these funds is dependent on a change in Icelandic Law which currently does not allow the distribution of ISK outside the country. Interest will accrue on these funds until the date of final settlement which is still unknown.

- Heritable

As at the end of September the Council had received £1.122m against our claim of £1.505m. Current estimates given by the Administrator project a total recovery of 85% or approximately £1.3m.

- Kaupthing, Singer and Friedlander

As at the end of September the Council had received £2.318m against our claim of £3.175m. Current estimates given by the Administrator project a total recovery of between 84% to 86.5% or approximately £2.7m with the majority of repayments being received by April 2013.

REPORT AUTHOR

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LIST OF BACKGROUND PAPERS

Background Papers:-	Local Government Act 2003
	CIPFA Code of Practice on Treasury Management in Public Services 2011
	Treasury Management Strategy & Prudential Indicators Report 2012/13
	Budget & Medium Term Financial Strategy 2012/13
	Financial Healthcheck Period 6, September 2012
	CIPFA Treasury Management Benchmarking Club Report Quarter 2 September 2012

APPENDICES

APPENDIX 1 – Prudential Indicators

APPENDIX 2 – Current Investments

APPENDIX 3 – Icelandic Banking Situation

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