Appendix A

TREASURY MANAGEMENT

AND

PRUDENTIAL INDICATORS

MID YEAR REPORT

2011/12

MID YEAR REPORT 2011-12

1.0 INTRODUCTION AND BACKGROUND

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)

This table shows the revised estimates for capital expenditure and reflects the changes since the capital programme was agreed as part of the 2011/12 budget setting process.

Capital Expenditure by Service	2011/12 Original Estimate £000	Current Position £000	2011/12 Revised Estimate £000
Council Housing	1,207	564	1,591
Private Housing	300	88	447
Council Property	1,713	2,199	3,130
Vehicle, Plant & Equipment	15	11	36
Information Technology	45	3	46
Recreation, Leisure & Tourism	0	0	855
Planning and Conservation	0	2	31
Total	3,280	2,867	6,136

The change between the original estimate and the revised estimate is principally due to carry forwards of schemes from 2010/11 plus an additional scheme approved in the current year for redevelopment works at Waterfield Leisure Pools.

2.1 Impact of Capital Expenditure Plans

2.1.1 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. 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	2011/12 Original Estimate £000	2011/12 Revised Estimate £000
Supported Expenditure	3,280	4,783
Unsupported Expenditure (borrowing)	0	1,353
Total spend	3,280	6,136
Financed by:		
Capital receipts	260	430
Capital grants	235	252
Capital Reserves	1,503	2,365
Revenue	1,282	1,736
Total Financing	3,280	4,783
Borrowing Need	**0**	**1,353**

The level of borrowing need has increased from the original estimate due to schemes being carried forward from prior years and also additional schemes approved in year to be financed via borrowing.

2.2 **Changes to the Capital Financing Requirement (PI), External Debt and the Operational Boundary (PI)**
The table below 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.

2.2.1 **Prudential Indicator – Capital Financing Requirement**
The capital financing requirement has been revised from the original prediction to take account of increases in the borrowing need arising out of in year scheme approvals to be financed via borrowing.

2.2.2 **Prudential Indicator – External Debt / the Operational Boundary**

	2011/12 Original Estimate £000	Current Position £000	2011/12 Revised Estimate £000
Prudential Indicator – Capital Financing Requirement			
CFR – Non Housing	5,406	[redacted]	6,422
CFR – Housing	4,282		4,282
Total CFR	9,688		10,704
Net movement in CFR	-254		+1,111
Prudential Indicator – The Operational Boundary			
Borrowing	11,510	8,980	8,980
Other long term liabilities	190	220	220
Total Debt 31 March	11,700	9,200	9,200

3.0 **LIMITS TO BORROWING ACTIVITY**

3.1 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. The current position shows a predicted under-borrowed position against the original prediction due to the use of internal cash flow balances.

	2011/12 Original Estimate £000	Current Position £000	2011/12 Revised Estimate £000
Gross Borrowing	9,511	6,988	6,891
Plus Other Long Term liabilities	189	221	221
Less Investments	-638	-3,850	-395
Net Borrowing	9,062	3,359	6,717
CFR (year end position)	9,688	10,704	10,704

No difficulties are envisaged for the current or future years in complying with this PI.

3.2 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	18,810	18,780	18,810
Other long term liabilities	190	220	190
Total	19,000	19,000	19,000

The change in the authorised limit as illustrated in the current position column has arisen due to lower predicted levels of borrowing due to the utilisation of internal cash flow balances, which has also enabled the repaying of maturing debt.

4.0 INTEREST RATE MOVEMENTS AND EXPECTATIONS

The Council's treasury management advisers have provided the following view of the economy for the first half of the year.

4.1 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 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 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.

4.2 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.

The announcement by the Monetery Policy Committee(MPC) on 6 October of a second round of quantitative easing (QE) 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.

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.

4.3 Outlook for the next six months of 2011/12

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.

4.4 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**

5.0 **TREASURY STRATEGY 2011/12 – 2013/14**

5.1 **Debt Activity during 2011/12**

The expected borrowing need is set out below:

	2011/12 Original Estimate £000	**Current Position £000**	**2011/12 Revised Estimate £000**
CFR (year end position)	9,688	10,704	10,704
Less Other Long Term Liabilities	-221	-221	-221
Net Adjusted CFR (y/e position)	9,467	10,483	10,483
Borrowing to-date	6,988	5,538	5,538
Under/over borrowing	-2,479	-4,945	-4,945
Expected need	0	1,353	1,353
Total Borrowing	6,988	6,891	6,891

The Council is currently under-borrowed to address investment counterparty risk and the cost of carry on investments (investments yield under 1%, long term borrowing rates are approximately 4.4%). There is interest rate risk, as longer term borrowing rates may rise, this position is being carefully monitored. Also, as a result of the Spending Review HM Treasury has instructed PWLB to increase the average interest rate on all new loans to an average of 1.00% above Government's cost of borrowing .This was brought in to effect on 20 October 2010. This will effect any new borrowing later in the year.

5.2 No new borrowing(s) have been undertaken to-date during the year.

Lender	Principal	Type	Interest Rate	Maturity
	£m		%	
N/A	0			

5.3 The revised budget position for debt charges is:

Debt charges	**2011/12 Original Estimate £000**	**Current Position £000**	**2011/12 Revised Estimate £000**
Borrowing	365	161	311
Other long term liabilities*	0	0	0
Total	365	161	311

6.0 **INVESTMENT STRATEGY 2011/12 – 2013/14**

6.1 **Key Objectives** - The objectives of the Council's investment strategy are safeguarding the repayment 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.

6.2 **Current Investment Position** - The Council held £3.85m of investments at 30/09/2011, and the constituent parts of the investment position are:

Sector	Country	Up to 1 year £000	1 - 2 years £000	2 – 3 years £000
Banks	UK	3,000	0	0
Building Societies	UK	500	0	0
Debt Management Office	UK	350	0	0
Total		3,850	0	0

6.3 The revised budget position for investment income is:

Interest Receivable	2011/12 Original Estimate £000	Current Position £000	2011/12 Latest Forecast £000
Income	11	9	14
Total	11	9	14

6.4 **Risk Benchmarking** – A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance. Discrete security and liquidity benchmarks are new requirements to the Member reporting, although the application of these is more subjective in nature. These were first set in the Treasury Strategy Report on 2 February 2011.

The following reports the current position against the benchmarks originally approved.

6.5 **Security** - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, was set as follows:

0.08% historic risk of default when compared to the whole portfolio.

The investment portfolio was maintained within this overall benchmark during the year to date with the average risk, at 30 September, being 0.001% or £32 on the total sum invested (£3.85M)—it is not an expectation of default.

The security benchmarks for each individual year were set as:

Benchmarks	1 year	2 years	3 years	4 years	5 years
Maximum (current)	**0.06%**	**0.06%**	**0.08%**	**N/A**	**N/A**
Maximum (revised)	**0.06%**	**0.06%**	**0.08%**	**N/A**	**N/A**

These benchmarks were not breached during the 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. The benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members. As this data is collated, trends and analysis will be collected and reported.

6.6 **Liquidity** – In respect of this area the Council set liquidity facilities/benchmarks to maintain:

- Bank overdraft - £1.0m
- Liquid short term deposits of at least £0.25m available with a week's notice.
- Weighted Average Life benchmark is expected to be 1.5 years, with a maximum of 3.0 years.

The actual against the benchmark as at 30 September 2011 was 10.82 days which is well within the prescribed limit approved. This is because the current portfolio has been kept relatively short.

Liquidity arrangements should be adequate during the remainder of the year.

Yield - Local measures of yield benchmarks are:

- The investment return to date is 0.38% against the seven day money market rate of 0.39% (-£488)

The security of the investments is paramount and as such a large proportion of the surplus monies has been placed with the Debt Management Office resulting in a lower rate of return against the benchmark. In order to improve performance money market funds were introduced from 1 September 2011.

6.7 **Treasury Management Indicators**

6.8 **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.

	2011/12 Original Indicator	**2011/12 Revised Indicator**
	%	%
Non-HRA	6.78	5.29
HRA	2.71	2.80

We are on target to achieve the original forecast for ratio of financing costs to net revenue. The figure in respect of HRA is predicted to be slightly higher than the original estimate due to a marginal increase in the interest rate used to calculate the HRA loan charge. (3.73% original, 4.15% revised indicator)

7.0 **TREASURY MANAGEMENT PRUDENTIAL INDICATORS**

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

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

	2011/12 Original Indicator £m	**Current Position £m**	**2011/12 Revised Indicator £m**
Prudential indicator limits based on debt net of investments			
Limits on fixed interest rates	12.0	7.0	12.0
Limits on variable interest rates	7.0	0.0	7.0

7.3 **Maturity Structures Of Borrowing** – These gross limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing.

	2011/12 Original Indicator	Current Position	2011/12 Revised Indicator
Maturity Structure of fixed borrowing			
Under 12 months	0-100%		0-100%
12 months to 2 years	0-100%		0-100%
2 years to 5 years	0-100%		0-100%
5 years to 10 years	0-100%		0-100%
10 years and above	0-100%		0-100%

7.4 **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.

	2011/12 Original Indicator £m	Current Position £m	2011/12 Revised Indicator £m
Maximum principal sums invested > 364 days[1]			
Cash deposits	1	0	1

[1] Maximum limit of 100% applies to each period. The principal / percentage amount given is the limit for investments that have maturities of longer than one year at year end.