

**WYRE FOREST DISTRICT COUNCIL****CABINET**  
**16<sup>TH</sup> NOVEMBER 2010****Treasury Management Strategy Statement and  
Annual Investment Strategy  
Mid-year Review Report 2010/11**

<b>OPEN</b>	
<b>SUSTAINABLE COMMUNITY STRATEGY THEME:</b>	Stronger Communities
<b>CORPORATE PLAN AIM:</b>	A Well-Run and Responsive Council
<b>CABINET MEMBER:</b>	Councillor N J Desmond
<b>DIRECTOR:</b>	Director of Resources
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<b>APPENDICES:</b>	Appendix 1 - Investment Portfolio as at 30/09/2010 Appendix 2 - Prudential and Treasury Indicators

**1. PURPOSE OF REPORT**

- 1.1 To provide Members with a mid-year review of its treasury management policies, practices and activities in accordance with revised CIPFA Treasury Management Code of Practice.

**2. RECOMMENDATION**

**The Cabinet is recommended to:-**

- 2.1 **Note this Treasury Management Mid-year Review.**
- 2.2 **Recommend this Mid-year Review to Council on 1<sup>st</sup> December 2010.**

**3. BACKGROUND**

- 3.1 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. ”

- 3.2 The Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 24<sup>th</sup> February 2010.
- 3.3 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 Treasury Management Review Panel who considered and endorsed this report on the 3<sup>rd</sup> November 2010, and made recommendations to the Corporate Resources Scrutiny Committee on the 11<sup>th</sup> November 2010.

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 2010/11.
  - A review of the Treasury Management Strategy Statement and Annual Investment Strategy.
  - A review of the Council's investment portfolio for 2010/11.
  - A review of the Council's borrowing strategy for 2010/11.
  - A review of any debt rescheduling undertaken during 2010/11.
  - A review of compliance with Treasury and Prudential Limits for 2010/11.
- 3.4 Butlers were the Council's Treasury Advisor's until the recent retender exercise in August, following which, Sector were appointed from 1<sup>st</sup> September 2010.

#### **4. ECONOMIC UPDATE**

##### **4.1 Global economy**

The sovereign debt crisis peaked in May 2010 prompted, in the first place, by major concerns over the size of the Greek government's total debt and annual deficit. However, any default or write down of Greek debt would have substantial impact on other countries, in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May.

Growth in the US, UK and the Euro zone in quarter 2 of 2010 was particularly driven by strong growth in the construction sector catching up from inclement weather earlier in the year and is unlikely to be repeated; general expectations are for much more subdued figures for the remainder of 2010. Market expectations for all three sectors of the economy is that these have all peaked and are pointing downwards, though not necessarily in to negative territory.

## 4.2 UK economy

Following the general election in May 2010, the coalition government has put in place an austerity plan to carry out correction of the public sector deficit over the next five years. The inevitable result of fiscal contraction will be major job losses during this period, in particular in public sector services. This will have a knock on effect on consumer and business confidence. House prices have started a negative trend during the summer and mortgage approvals are at very weak levels and also declining.

**Economic Growth** – GDP growth is likely to have peaked at 1.2% in quarter 2 of 2010.

**Unemployment** – the trend of falling unemployment (on the benefit claimant count) has now been replaced since July with small increases which are likely to be the start of a new trend of rising unemployment.

**Inflation and Bank Rate** – CPI has remained high so far during 2010. It peaked at 3.7% in April and has fallen back to 3.1% in August. RPI remains high, at 4.7% in August. Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years. The last quarterly Inflation Report in August showed a significant undershoot after the end of 2011.

The Bank of England finished its programme of quantitative easing with a total of £200bn in November 2009 (although there is currently some increase in expectations that there might be a second round of quantitative easing).

Sector's view is that there is unlikely to be any increase in Bank Rate until the middle of 2011.

**AAA rating** – prior to the general election, credit rating agencies had been issuing repeated warnings that unless there was a major fiscal contraction, then the AAA sovereign rating was at significant risk of being downgraded. Sterling was also under major pressure during the first half of the year. However, after the Chancellor's budget on 22<sup>nd</sup> June, Sterling has strengthened against the US dollar and confidence has returned that the UK will retain its AAA rating. In addition, international investors now view UK government gilts as being a safe haven from EU government debt. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and PWLB rates.

## 4.3 Sector's view for the next six months of 2010/11

It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be, and there are a range of views in the market. Sector has adopted a moderate view. There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- the speed of economic recovery in the US and EU
- the degree to which government austerity programmes will dampen economic growth

- the speed of rebalancing of the UK economy towards exporting and substituting imports
- changes in the consumer savings ratio
- 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 potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy

The overall balance of risks is weighted to the downside and there is some risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

#### 4.4 Sector's interest rate forecast

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13
Bank Rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.50%	3.00%	3.25%	3.25%
5yrPW LB Rate	3.05%	3.05%	3.25%	3.45%	3.65%	3.85%	4.15%	4.45%	4.65%	4.95%	5.25%	5.25%
10yrPW LB Rate	4.15%	4.15%	4.25%	4.55%	4.75%	4.85%	5.15%	5.25%	5.45%	5.45%	5.75%	5.75%
25yrPW LB Rate	5.05%	5.15%	5.15%	5.25%	5.35%	5.55%	5.55%	5.65%	5.85%	5.85%	5.85%	5.85%
50yrPW LB Rate	4.95%	5.05%	5.05%	5.15%	5.25%	5.45%	5.45%	5.55%	5.75%	5.75%	5.75%	5.75%

## 5. TREASURY MANAGEMENT POLICY AND STRATEGY UPDATE

The Treasury Management Policy and Strategy (TMPS) for 2010/11 was approved by this Council on 24<sup>th</sup> February 2010. The Council's Annual Investment Strategy, which is incorporated in the TMPS, outlines the Council's investment priorities as follows:

- Security of Capital
- Liquidity

The Council will also aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term (maximum loan period of 24 months), and only invest with highly credit rated financial institutions, using the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria.

A breakdown of the Council's investment portfolio is shown in Section 6 and appendix 1 of this report.

Borrowing rates have been at historically low rates during the first six months of the 2010/11 financial year. Any new external borrowing undertaken has been identified in Section 6 of this report.

Investments and borrowing during the first six months of the year have been in line with the strategy, and there have been no deviations from the strategy.

As outlined in Section 4 above, there is still considerable uncertainty and volatility in the financial and banking market, both globally and in the UK. Following the appointment of Sector, as the Council's Treasury Management advisors, the current Treasury Management Policy and Strategy is now being revised. This revision will include the use of Sector's suggested creditworthiness approach, including sovereign credit rating and credit default swap (CDS) overlay information provided by Sector.

## **6. INVESTMENT PORTFOLIO 2010/11**

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.

The investment portfolio yield for the first six months of the year is 0.97% against a benchmark (7 Day LIBID) of 0.42%.

A full list of investments held as at 30<sup>th</sup> September 2010, is shown in Appendix 1. The Table below, summarises investments held at the 1<sup>st</sup> April 2010 compared to investments held at the 30<sup>th</sup> September 2010.

Investments	1 <sup>st</sup> April 2010	Average Rate of Return
Clydesdale Bank	3,000,000	0.8%
Royal Bank of Scotland	2,985,000	0.85%
Santander Bank UK	3,000,000	0.8%
Barclays Bank	2,000,000	1.33%
Lloyds TSB Bank	1,500,000	1.00%
Bank of Scotland Bank	1,500,000	1.12%
<b>Total</b>	<b>13,985,000</b>	
Investments	30th September 2010	Average Rate of Return
Clydesdale Bank	2,830,000	0.5%
Royal Bank of Scotland	2,985,000	0.85%
Santander Bank UK	2,000,000	0.8%
Barclays Bank	2,000,000	1.33%
Santander Bank UK	1,000,000	1.41%
Lloyds TSB Bank	1,500,000	1.15%
Bank of Scotland Bank	1,500,000	1.08%
<b>Total</b>	<b>13,815,000</b>	

As illustrated in the economic background section above, investment rates available in the market are at a historical low point. The average level of funds available for investment purposes in the first six months of 2010/11 was £13,794,818m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Benchmark	Benchmark Return	Council Performance	Investment Interest Earned
7 day	0.42%	0.97%	£67,260

As illustrated, the authority outperformed the benchmark by 55 bank basis points (bps). The Council's Original budgeted investment return for 2010/11 is £207,820, and performance for the year to date is £67,260. The revised budget will take into account the collapse of the national interest rates.

**7. NEW EXTERNAL BORROWING**

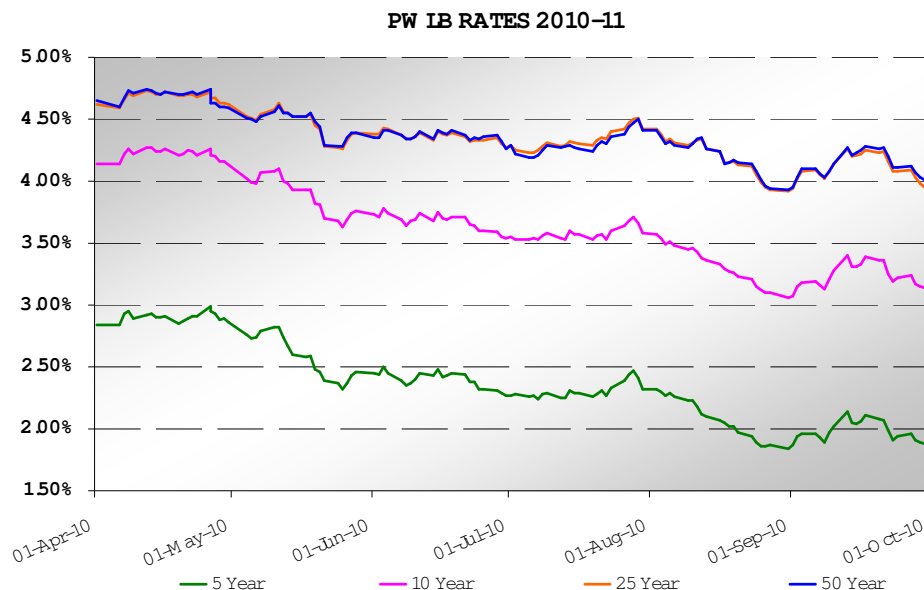
The Council's capital financing requirement (CFR) for 2010/11 is £1.697m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

Sector's central target rate for new external long term borrowing (25 years) for the first six months of 2010/11 started at 4.65% and fell progressively to 4.20%

As outlined below, the general trend has been a reduction in interest rates during the six months, across all bands, with the low points occurring in the middle to end of August. The high points were in early to mid April.

Further borrowing may be undertaken during the second half of this financial year, the Director of Resources will use his delegation to determine if this is from internal or external sources.

The graph and table below show the movement in PWLB rates for the first six months of the year and provide benchmarking data showing high and low points. It should also be noted, that following the Government's Comprehensive Spending review on the 20<sup>th</sup> October, 2010 PWLB rates increased with immediate effect by 1%.



**PWL B BORROWING RATES 2010/11 for 1 to 50 years**

	1	2	3	4	5	10	25	50
1. 4.2010	0.81%	1.37%	1.91%	2.40%	2.84%	4.14%	4.62%	4.65%
30.9.2010	0.64%	0.91%	1.22%	1.55%	1.88%	3.14%	3.95%	4.01%
HIGH	0.93%	1.52%	2.07%	2.56%	2.99%	4.27%	4.73%	4.74%
LOW	0.60%	0.89%	1.20%	1.52%	1.84%	3.06%	3.92%	3.93%
spread	0.33%	0.63%	0.87%	1.04%	1.15%	1.21%	0.81%	0.81%
average	0.73%	1.15%	1.58%	1.99%	2.37%	3.65%	4.35%	4.35%
high date	26/04/2010	26/04/2010	26/04/2010	26/04/2010	26/04/2010	12/04/2010	12/04/2010	26/04/2010
low date	15/06/2010	24/08/2010	25/08/2010	31/08/2010	31/08/2010	31/08/2010	31/08/2010	31/08/2010

**8. DEBT RESCHEDULING**

Since this Council currently has no external debt, there has been no requirement for debt rescheduling during the first six months of 2010/11.

**9. COMPLIANCE WITH TREASURY AND PRUDENTIAL LIMITS**

It is a statutory duty for the Council to determine and keep under review the “Affordable Borrowing Limits”. Council’s approved Treasury and Prudential Indicators (affordability limits) are outlined in the approved Treasury Management Policy and Strategy Report.

During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council’s Treasury Management Strategy Statement and in compliance with the Council’s Treasury Management Practices.

The Prudential and Treasury Indicators are shown in Appendix 2.

**10. LOCAL ISSUES**

10.1 The most significant issue to affect the Council relates to the exposure of investments with links to Icelandic Banks. In reacting to this situation the Council established the Treasury Management Review Panel which examined the

circumstances leading up to the placing of the particular investments and continues to consider recommendations in relation to the Council's lending lists and other relevant Treasury Management matters.

- 10.2 The Council had £9m invested in Icelandic Banks at the time of collapse. Four dividends have been received up to 30<sup>th</sup> September 2010 from both Heritable Bank and Kaupthing Singer & Freidlander (KSF), with further dividends expected, before the end of the current financial year.

The progress on the Landsbanki claim is more complex, as Council is aware the "preferred" status awarded to Local Authority depositors of Landsbanki has been challenged by other creditors through the Icelandic courts. The Council has been working with the LGA and Bevan Brittan (solicitors working on behalf of all UK local authorities) in helping to prepare a response to this challenge which was submitted to the Icelandic courts by the deadline of 3 September 2010. The selected test cases are expected to be heard by the Icelandic Court in January 2011.

The table below details the Councils Icelandic investments as at 30<sup>th</sup> September 2010, a fifth dividend of 4.14p in £, was paid by Heritable on 18<sup>th</sup> October 2010, reducing the principal investment to £546,140. It is expected that KSF will pay a fifth dividend sometime in November/December 2010.

**Icelandic Investments as at 30<sup>th</sup> September 2010**

Bank	Original Investment £	Interest Claimed £	Total Claim £	Dividends Received £	Balance Outstanding including Interest Due £	Balance Outstanding Principal Only £
Landsbanki	3,000,000	571,711	3,571,711	0	3,571,711	3,000,000
Kaupthing Singer & Friedlander	5,000,000	156,378	5,156,378	2,320,370	2,836,008	2,750,000
Heritable Bank	1,000,000	31,110	1,031,110	425,364	605,746	587,540
<b>Total</b>	<b>9,000,000</b>	<b>759,199</b>	<b>9,759,199</b>	<b>2,745,734</b>	<b>7,013,465</b>	<b>6,337,540</b>

- 10.3 Over this, and the ensuing years, the funds available for investment will reduce as the Council progresses on its Transformation Agenda in areas such as the development of Single Site, the completion of the implementation of the ICT Strategy, new arrangements for the collection of recycling, and the provision (in partnership) of a new cemetery and crematorium. Each of the schemes above are being pursued to ensure that the Council can reduce the on-going cost of delivering services.
- 10.4 Over the coming years the Council is also scheduled to make disposals of assets, however, careful consideration will be made on each opportunity to ensure that the Council sells at a time that maximises the return to the authority.

**11. KEY ISSUES**

- 11.1 The Key issues are contained in sections 3 to 10 of this report.
- 11.2 As reported previously, the returns the Council is currently receiving from investments are significantly lower than those achieved during years up to 2007/08.



Although we are forecasting increases in interest rates in later years, increases are expected to be modest and implemented over a long period.

**12. FINANCIAL IMPLICATIONS**

- 12.1 The Financial Implications of the Treasury management function will be included in the Council's Medium Term Financial Strategy and Four Year Budget and Policy Framework currently being prepared.

**13. LEGAL AND POLICY IMPLICATIONS**

- 13.1 The Local Government Act 2003 supplemented by Regulations set out a new framework for a prudential system for local authority capital finance. This Act, together with CIPFA's Prudential Code for Capital Finance in Local Authorities, came into effect on 1<sup>st</sup> April 2004. This code together with recent revised editions, guides decisions on what Local Authorities can afford to borrow and has statutory backing under Regulations issued in accordance with the Local Government Act 2003.
- 13.2 Adoption of the CIPFA Code of Practice on Treasury Management in the Public Services as part of the Authority's Standing Orders and Financial Regulations, gives it the status of a "code of practice made or approved by or under any enactment", and hence proper practice under the provisions of the Local Government and Housing Act 1989.

**14. RISK MANAGEMENT**

- 14.1 The Council is aware of the risks of passive management of the treasury portfolio. With the support of its external consultants we continue to proactively manage our investments. Butlers were the Council's advisors until the recent retender exercise following which Sector were appointed from 1<sup>st</sup> September 2010.
- 14.2 Shorter-term variable rates and likely future movement in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the lending list, accurately forecasting returns can be difficult.

**15. EQUALITY IMPACT ASSESSMENT**

- 15.1 This is a financial report and there is no requirement to consider an Equality Impact Assessment.

**16. CONCLUSION**

- 16.1 See Recommendations.

**17. CONSULTEES**

- 17.1 Sector Treasury Advisors.  
17.2 Cabinet.  
17.3 Leader of the Council.  
17.4 Corporate Management Team.  
17.5 Treasury Management Review Panel.

**18. BACKGROUND PAPERS**

- 18.1 Local Government Act 2003.
- 18.2 CIPFA's Revised Prudential Code for Capital Finance in Local Authorities, 2009.
- 18.3 CIPFA's Revised Code of Practice on Treasury Management in the Public Services, 2009.
- 18.4 Local Government and Housing Act 1989.
- 18.5 Cabinet Report 22/09/2009– Report on Treasury Management Service and Actual Prudential Indicators 2008/2009.
- 18.6 Council 25/02/09 – The Prudential System of Local Government Finance and the Treasury Management Policy and Strategy Report 2009/2010.
- 18.7 Cabinet Report 21/07/2009 – Treasury Management Update.
- 18.8 Council approval 24/02/2010 of The Prudential System of Local Government Finance and the Treasury Management Policy and Strategy Report 2010/11.

**APPENDIX 1 Investment portfolio as at 30<sup>th</sup> September 2010**

<b>Bank</b>	<b>Investment £</b>	<b>Interest Rate %</b>	<b>Date of Investment</b>	<b>Date of Maturity</b>	<b>Type of Investment</b>
Clydesdale Bank	2,830,000	0.50	30/09/2010	01/10/2010	Instant Access
Royal Bank of Scotland	2,985,000	0.85	30/09/2010	01/10/2010	Instant Access
Santander UK	2,000,000	0.80	30/09/2010	01/10/2010	Instant Access
Barclays Bank	2,000,000	1.33	05/11/2009	05/11/2010	12month Fixed
Santander UK	1,000,000	1.41	13/04/2010	13/01/2011	9month Fixed
Lloyds TSB	1,500,000	1.15	10/08/2010	10/11/2010	3month Fixed
Bank of Scotland	1,500,000	1.08	15/09/2010	15/12/2010	3month Fixed
<b>Total Investments</b>	<b>13,815,000</b>				

## APPENDIX 2 Prudential and Treasury Indicators

PRUDENTIAL INDICATORS	2008/09	2009/10	2010/11	2011/12	2012/13
<b>Extract from budget and rent setting report</b>	<b>actual</b>	<b>actual</b>	<b>estimate</b>	<b>estimate</b>	<b>estimate</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Capital Expenditure</b>					
	4,391	6,147	10,991	9,370	1,801
<b>TOTAL</b>	<b>4,391</b>	<b>6,147</b>	<b>10,991</b>	<b>9,370</b>	<b>1,801</b>
<b>Ratio of financing costs to net revenue stream</b>					
	(3.51)%	1.80%	2.19%	3.19%	4.77%
<b>Net borrowing requirement</b>					
brought forward 1 April	(23,787)	(18,090)	(13,010)	(13,132)	(3,164)
carried forward 31 March	(18,090)	(13,010)	(13,132)	(3,164)	(1,719)
in year borrowing requirement	0	0	0	0	0
<b>Capital Financing Requirement as at 31 March</b>					
	1,829	1,697	4,528	5,913	6,483
<b>Annual change in Cap. Financing Requirement</b>					
	(71)	(132)	(2,831)	(1,385)	(570)
<b>Incremental impact of capital investment decisions</b>			<b>£ p</b>	<b>£ p</b>	<b>£ p</b>
Increase in council tax (band D) per annum			0.26	(2.73)	(3.50)

## Agenda Item No. 8.3

TREASURY MANAGEMENT INDICATORS	2008/09	2009/10	2010/11	2011/12	2012/13
	<b>actual</b>	<b>actual</b>	<b>estimate</b>	<b>estimate</b>	<b>estimate</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Authorised Limit for external debt -</b>					
borrowing	4,000	5,000	6,000	9,000	10,000
other long term liabilities	0	0	0	0	0
<b>TOTAL</b>	<b>4,000</b>	<b>5,000</b>	<b>6,000</b>	<b>9,000</b>	<b>10,000</b>
<b>Operational Boundary for external debt -</b>					
borrowing	300	2,500	800	2,000	5,000
other long term liabilities	0	0	0	0	0
<b>TOTAL</b>	<b>300</b>	<b>2,500</b>	<b>800</b>	<b>2,000</b>	<b>5,000</b>
<b>Actual external debt</b>	<b>38</b>	<b>35</b>	<b>32</b>	<b>30</b>	<b>28</b>
<b>Upper limit for fixed interest rate exposure</b>					
Net principal re fixed rate investments	100%	100%	100%	100%	100%
<b>Upper limit for variable rate exposure</b>					
Net principal re variable rate borrowing / investments	100%	100%	100%	100%	100%
<b>Upper limit for total principal sums invested for over 364 days</b>					
(per maturity date)	£	£	£	£	£
	15m	10m	7m	4m	2m

Maturity structure of fixed rate borrowing during 2010/11	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%