Appendices
10

NORTHAMPTON
BOROUGH COUNCIL

Item No.

CABINET REPORT

Report Title	TREASURY MANAGEMENT MID YEAR REPORT 2010-11

AGENDA STATUS: **PUBLIC**

Cabinet Meeting Date:	15 December 2010
Key Decision:	NO
Listed on Forward Plan:	YES
Within Policy:	YES
Policy Document:	NO
Directorate:	Finance and Support
Accountable Cabinet Member:	David Perkins
Ward(s)	Not Applicable

1. Purpose

1.1 To inform the Cabinet of the Council's performance in relation to its treasury management activities, including its borrowing and investment strategy, for the period 1 April to 30 September 2010.

1.2 To inform Cabinet of a change to the Council's Investment Strategy, approved by the Chief Financial Officer in August 2010.

1.3 To ask Cabinet to recommend to Council that they approve revisions to the Council's prudential indicators for Capital Expenditure and the Capital Financing Requirement for 2010-11.

2. Recommendations

2.1 That Cabinet recommend to Council that they note the Council's treasury management activities and performance for the period 1 April to 30 September 2010.

2.2 That Cabinet recommend to Council that they note the change to the Council's Investment Strategy detailed at paragraphs 3.2.27 to 3.2.28.

2.3 That Cabinet recommend to Council that they approve revisions to the Council's prudential indicators for 2010-11 for Capital Expenditure and the Capital Financing Requirement as set out at paragraphs 3.2.51 and 3.2.54.

3. Issues and Choices

3.1 Report Background

3.1.1 The Council adopted the CIPFA Code of Practice on Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes ("the Treasury Management Code of Practice") following its publication in 2001.

3.1.2 During 2009, in the light of the impacts on local authorities of the Icelandic bank situation in 2008, CIPFA published a fully revised second edition of the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes and a fully revised third edition of the Guidance Notes for Local Authorities. The adoption of the updated code was formally minuted as a decision at the Council meeting of 25 February 2010.

3.1.3 The latest Treasury Management Code of Practice and the associated the guidance notes include recommendations on reporting requirements, including a new requirement for an annual mid year report on treasury activities. The table below shows how the specific requirements have been incorporated into this report.

Reporting Requirement	Reference
Activities undertaken	3.2.7 – 3.2.23 Annexes B,C,D,E,F
Variations (if any) from agreed policies and practices	3.2.24 – 3.2.33 Annex H
Interim performance report	3.2.34 – 3.2.40 Annex G
Regular monitoring	3.2.41 – 3.2.45 Annex H,I,J
Monitoring of treasury management indicators for local authorities	3.2.46 – 3.2.47 Annex H

3.1.4 The following topics are also covered in this report

Topic	Reference
Economic environment and interest rates	3.2.1 – 3.2.6 Annex A
Monitoring of prudential indicators for local authorities	3.2.48 – 3.2.54 Annex I
Monitoring of debt financing budget	3.2.55 – 3.2.56 Annex J

3.2 Issues and Choices

Economic Environment and Interest Rates

3.2.1 An analysis of the economic position as at the end of September 2010, is attached at **Annex A.** This has been provided by Sector, the Council's treasury management advisers.

3.2.2 The Monetary Policy Committee left bank base rate unchanged at 0.50% throughout the first half of 2010-11, and maintained its level of quantitative easing at £200 billion.

3.2.3 Investment rates are at a historical low point and remained relatively stable throughout the first six months of 2010-11, with the average 7 day LIBID rate 0.07% below base rate, and LIBOR 0.05% above.

3.2.4 Interest rate views continue to differ between forecasters, and some forecasts have been revised downwards during the year following developments in the economy. **Annex A** includes the latest interest rate forecast provided by Sector.

3.2.5 Expectations for future bank base rates vary; the earliest forecast of a base rate increase is March 2011, while some forecasters predict the bank rate will remain at its current level until 2012.

3.2.6 Borrowing rate forecasts have been revised following an unexpected fall in bond yields in August and September 2010. The overall view is that borrowing rates are currently at a low point and will begin to rise, although opinion is varied on the timing and degree of future increases.

Activities undertaken

Investments

3.2.7 The Council's overall investments figure as at 30 September 2010 was £78m; average balances for the six-month period to 30 September were £71m. The lowest and highest balances during the period were £54m and £89m.

3.2.8 Since the start of the year 40 new fixed term deposits have been entered into ranging in value between £5k and £5m, at rates between 0.33% and 1.90%. The average value of each single investment was £2.6m, and the average interest rate achieved for fixed deposits was 1.12%. Fixed term deposits make up an average of 82% of the Council's investment portfolio, the remainder being balances held in instant access deposit accounts. **Annex B** shows the Council's investments and deposit account balances at 30 September 2010.

3.2.9 As investment interest rates are expected to rise from current levels, albeit slowly, the majority of investments have been made for relatively short periods, to ensure that funds are not tied up in long term investments at low rates in the future when available rates are higher. Keeping funds liquid ensures that the Council is able to take advantage of high interest rates for longer-term deals when they become available. Investment periods since the start of 2010-11 range from 16 days to 364 days, the average duration being 140 days. **Annex C** shows the maturity profile of the Council's investments at 30 September 2010.

3.2.10 Instant access deposit accounts have been used extensively during the first half of the year, in order to maintain liquidity and security of funds. The average balance held in deposit accounts since 1 April 2010 was £13m, around 18% of the Council's average investment portfolio.

3.2.11 Two of the deposit accounts currently used by the Council earn interest at relatively high rates, so are used in preference to short term fixed investments where possible, to increase the Council's rate of return on investments. In order to spread the Council's funds over a wider range of counterparties whilst ensuring sufficient liquidity, three more deposit accounts are in the process of being opened with two counterparties; one of these accounts will be instant access, the other two requiring fifteen and thirty days notice for transactions.

3.2.12 Due to changes in banking regulation to improve security of deposits, it may not be beneficial for banks to offer high interest rates on instant access accounts in the future, with customers being encouraged to place deposits for fixed periods instead. It is therefore likely that the banks could reduce the interest rates currently applicable on the Council's deposit accounts.

3.2.13 In order to maintain sufficient liquidity and prevent a fall in investment interest following these changes, the Council will shortly begin to use Money Market funds as well as deposit accounts. The use of money market funds will ensure liquidity, as they provide instant access. In addition, there will be increased capacity with investment counterparties as a result of the reduction in balances held in deposit accounts. This will enable more use to be made of direct deals at enhanced rates to maintain a sufficient rate of return on investments.

3.2.14 Money Market Funds currently earn interest at a lower rate than the Council's deposit accounts, but have a high security rating due to their diversification. Deposits placed with money market funds are distributed between a wide range of institutions, reducing the exposure to single counterparties, and therefore minimising the potential impact of a collapse of a particular institution on the fund and its investors.

3.2.15 The Council's treasury management advisors ran a Money Market Fund selection process on several AAA rated funds based on the Council's preferred selection criteria of size of fund, diversification and performance, and have recommended the three most suitable money market funds to use. An account has been set up with Ignis, the fund with the highest score based on these criteria, and the use of other funds will be arranged in the future to ensure the rates achieved remain competitive.

3.2.16 All investment activity has been carried out within the Council's counterparty policies and criteria, and with a clear strategy of risk management in line with the Council's treasury strategy for 2010-11. This has ensured that the principle of considering security, liquidity and yield in that order (SLY), has been consistently applied.

Borrowing

3.2.17 **Annex D** shows outstanding long-term borrowing at 30 September 2010 at amortised cost. The total long-term debt outstanding is £32m. Of this amount, 77% is in the form of money market LOBO loans, 19% is PWLB borrowing and the remaining 4% is the long-term element of an annuity loan with the Homes and Communities Agency (HCA). The amount of principal due within one year for the HCA annuity is treated as short term borrowing in the accounts.

3.2.18 No loans have been repaid since April 2010 other than the principal element (£16k) of the HCA annuity payment made in September. No rescheduling of loans took place in the first half of the year.

3.2.19 No new borrowing was arranged in the first six months of 2010-11. New PWLB loans totalling £6m were arranged during January 2010 on the advice of the Council's treasury advisors, Sector. As interest rates are forecast to rise in the short to medium term, these loans were arranged to fund capital expenditure over the next three years, in order to reduce the risk of being required to borrow externally in the future at a point when rates are high. It is currently anticipated that no further external borrowing will be taken during the next two years.

3.2.20 **Annex E** shows the Council's long-term debt maturity profile at 30 September 2010 at cash value. Two LOBO loans totalling £15.6m are due for repayment in 2014-15. As current interest rates are lower than the rates applicable to these loans, rescheduling of this debt at current rates would incur high premiums, and would therefore not be beneficial. Options for the repayment or rescheduling of these loans will be monitored and revisited nearer to their maturity date, with advice taken from the Council's external treasury consultants, Sector.

3.2.21 **Annex F** shows outstanding balances and applicable rates for short-term borrowing at 30 September 2010. The total outstanding for temporary borrowing at 30 September 2010 was £181k.

3.2.22 The Council has long-standing agreements with two local organisations, Billing Parish Council and Northampton Volunteering Centre, for the short-term deposit of funds with the Council. Accounting regulations require that these be treated in the accounts as short-term borrowing. The interest rate applicable on these accounts is set quarterly using the Council's average investment rate for the previous quarter, less 0.5% to cover administrative costs. The balances in these accounts during the period April to September 2010 were between £70k and £110k, at interest rates between 0.66% and 0.67%.

3.2.23 The principal element (£17k) of the HCA annuity repayment due within 12 months is also treated as short term borrowing in the accounts in order to comply with accounting requirements.

Variations (if any) from or to agreed policies and practices

Variation to Investment Strategy

3.2.24 The Council's Treasury Strategy for 2010-11 approved by Council on 25 February 2010 set the following criteria for selecting investment counterparties:

	Investments may be placed with counterparties within the maximum periods recommended by the Council's external treasury advisors, and which meet the following criteria:	**Additional limits**
(1)	Counterparties having sovereign ratings of AAA (Overseas or UK)	NBC **additional limits** in force will be £12m and a maximum of 12 months (364 days).
	Or:	
(2)	UK nationalised or part nationalised banking institutions	NBC **additional limits** in force will be £15m and a maximum of 12 months (364 days).
	Or;	
(3)	UK banks or building societies supported by the UK banking system support package	NBC **additional limits** in force will be £15m and a maximum of 2 years (729 days).

3.2.25 During the first six months of the year the maximum duration recommended by the Council's external treasury advisors for investments with counterparties falling in category (3) above was 364 days, effectively preventing the Council from placing any long term investments.

3.2.26 The Treasury Strategy for 2010-11 gives the authority to the Chief Financial Officer to make a change to the counterparty selection criteria in order to enable the effective management of risk in relation to investments.

3.2.27 In order to reduce the risk that the Council could be unable to take advantage of preferential interest rates for long term investments if they arose, the Chief Financial Officer agreed changes to the counterparty limits on 23 August 2010, increasing the range of counterparties available for investments over 364 days.

3.2.28 The new limits are as follows:

	Investments may be placed with counterparties within the maximum periods recommended by the Council's external treasury advisors, and which meet the following criteria:	**Additional limits**
(1)	Counterparties having sovereign ratings of AAA (Overseas or UK)	NBC **additional limits** in force will be £12m and a maximum of 12 months (729 days).
	Or:	
(2)	UK nationalised or part nationalised banking institutions	NBC **additional limits** in force will be £15m and a maximum of 12 months (729 days).
	Or;	
(3)	UK banks or building societies supported by the UK banking system support package	NBC **additional limits** in force will be £15m and a maximum of 2 years (729 days).

3.2.29 However, as long-term investment interest rates are currently at a low point and are expected to rise, no long-term investments have yet been entered into. Investments are currently being kept short term in order to ensure that sufficient funds are available to take advantage of higher interest rates when they become available.

Variation from and revision to Treasury Indicator

3.2.30 The Council agreed the treasury indicators for 2010-11 at their meeting of 25 February 2010. These included indicators for fixed and variable rate interest rate exposures. The indicator for fixed rate interest rate exposure was set at zero, meaning that fixed rate investments should remain in excess of fixed rate borrowing.

3.2.31 At the time of setting this indicator the Council had fixed rate investments of £10m and fixed rate borrowing of £7m, resulting in a negative indicator of £3m. The indicator was set based on the expectation that the fixed rate investment figure would drop to £8.5m in 2010-11 in line with the treasury strategy limit for investments over 364 days, and fixed rate borrowing would remain constant following the PWLB borrowing arranged in January 2010, resulting in a negative indicator of £1.5m.

3.2.32 Market conditions during the first half of the year were such that the Council had no suitable counterparties with which to invest for periods over 364 days, and as the existing investments over 364 days matured they were replaced with shorter-term investments classed as variable rate. The figure for fixed rate investments started the year at 1 April at £8m, dropped to £6m on 4 June, to £4m on 14 June, and to £2m on 16 June. The indicator was therefore positive from 4 June, and currently stands at £5m (positive). This is in excess of the previously set limit of zero.

3.2.33 This breach was reported to Council on 15th September 2010 and Council agreed a change to the indicator for fixed rate interest rate exposure to £10m for the remainder of 2010-11. This will allow the Council to hold all of its investments at under 364 days and also gives some scope for additional fixed rate borrowing to be taken out if required.

Interim performance report

3.2.34 The variance between the Council's monthly rate of return on investments and the average 7-day Libid rate for the month is used as a measure of treasury performance, where a high variance reflects a high level of performance.

3.2.35 The 7-day Libid rate has remained fairly constant at an average of 0.42% throughout the first half of 2010-11.

3.2.36 At the beginning of the year, the Council held a number of longer-term investments, which had been arranged in previous years in a higher interest rate environment. The inclusion of these investments when measuring the rate of return against the current Libid rate led to a high positive variance at the beginning of the year, which fell sharply in June and July when these investments matured.

3.2.37 During the first half of the year, the positive variance reported fell from 0.88% in April 2010 to 0.41% in July 2010. From August 2010 there has been a higher balance held in deposit accounts, which attract higher rates than short term investments, and performance has improved slightly again. The average rate of return on investments since April 2010 was 1.01%, giving an average positive variance of 0.59%.

3.2.38 As investment rates are expected to rise in the future, there is a possibility that at some point existing investments could be held at a rate lower than the market rates available. This could cause the Council's rate of return on investments to fall below the current LIBID rate, and would result in a negative variance. Most investments have been kept short term to safeguard against this risk, and under the advice of the Council's treasury advisors no investments with maturity periods over 364 days have been arranged this year.

3.2.39 Treasury staff are currently working on a more sophisticated measure of tracking investment performance against LIBID. If this proves workable the current method of measurement may shortly be replaced by the new methodology.

3.2.40 Investment performance to 30 September 2010 is attached at **Annex G.**

Regular monitoring

3.2.41 A schedule of current investments and deposit account balances showing counterparties used, investment durations and interest rates achieved is prepared weekly and reviewed by the Finance Manager, Capital and Treasury.

3.2.42 Monthly reconciliations are completed for outstanding investment principal, interest received, outstanding borrowing principal and interest paid to ensure all transactions have been made and recorded accurately.

3.2.43 The Chief Finance Officer receives monthly treasury investment performance data and minutes from monthly treasury management meetings.

3.2.44 Prudential and treasury indicators have been monitored monthly from July 2010 and a summary will be taken to monthly treasury management meetings from October 2010.

3.2.45 The debt financing and debt management budgets have been monitored monthly since the start of the year. Debt financing budget monitoring information is reported in the monthly dashboard reports to Cabinet.

Monitoring of treasury management indicators for local authorities

3.2.46 Treasury management indicators have been monitored monthly since July 2010 and the latest position will be reported at monthly treasury management meetings from October.

3.2.47 **Annex H** contains treasury management indicator monitoring information at 30 September 2010. This includes the revised treasury management indicator for fixed interest rate exposures approved by Council on 15th September 2010. Details of the revision to this indicator are given at paragraphs 3.2.30 to 3.2.33 above.

Monitoring of prudential indicators for local authorities

3.2.48 Prudential indicators have been monitored monthly since July 2010 and the latest position will be reported at monthly treasury management meetings from October.

3.2.49 **Annex I** contains prudential indicator monitoring information at 30 September 2010. This includes revisions to the Council's prudential indicators for 2010-11 for Capital Expenditure and Capital Financing Requirement as set out below.

Estimate of capital expenditure 2010-11

3.2.50 This prudential indicator requires reasonable estimates of the total of capital expenditure to be incurred. It is in the nature of capital expenditure to have variations to the capital programme as the year proceeds, for example as new grant or other third party funding becomes available, or to accommodate slippage from the previous year. This is acknowledged in the Prudential Code.

3.2.51 Revised estimates for capital expenditure for 2010-11 are shown below and at **Annex I.** The estimates are consistent with the latest proposed capital programme for 2010-11 submitted to Cabinet on 3 November 2010 (Finance Monitoring Dashboard Report to end of August 2010).

Capital Expenditure		
	2010-11 Estimate £000	2010-11 Estimate at 31/08/2010 £000
General Fund	9,579	17,142
HRA	15,911	16,874
Total	**25,490**	**34,016**

3.2.52 The £7.5m increase in the General Fund figure is a result of the inclusion of slippage from 2009-10 (£3.6m) and the addition of new schemes into the capital programme (£3.9m). The additional schemes include the Cliftonville office move at £1.9m.

Estimate of Capital Financing Requirement (CFR) 2010-11

3.2.53 In day-to-day cash management no distinction can be made between revenue cash and capital cash. External borrowing may arise as consequence of all the financial transactions of the authority, and not simply those arising from capital spending. However the Capital Financing Requirement reflects the local authority's need to borrow for a capital purpose.

3.2.54 Revised estimates for the Capital Financing Requirement for 2010-11 are shown below and at Annex I. The revisions to the estimates of CFR arise primarily as a result of changes to the latest forecasts of borrowing to fund capital expenditure in 2010-11, compared to original estimates. The figures are consistent with the 2009-10 Statement of Accounts and with the borrowing requirements of the latest forecast capital programme for 2010-11.

Capital Financing Requirement (Closing CFR)		
	2010-11 31 March 2011 Estimate £000	2010-11 31 March 2011 Estimate at 31/08/2010 £000
General Fund	31,059	30,923
HRA	(6,175)	(6,175)
Total	**24,884**	**24,748**

Monitoring of debt financing budget

3.2.55 The debt financing budget has been monitored monthly since the beginning of the year; the latest forecast at 30 September 2010 is attached at **Annex J.**

3.2.56 There is currently a net underspend of £152k forecast for debt financing in 2010-11. This is mainly due to higher cash balances available for investment than budgeted.

4. Implications (including financial implications)

4.1 Policy

4.1.1 The Council is required to adopt the latest CIPFA Treasury Management Code of Practice, and to set and agree the following policy and strategy documents:

a) A Treasury Management Policy Statement

b) Treasury Management Practices (TMPs) and TMP Schedules

c) An annual Treasury Strategy incorporating:

(i) The Capital Financing and Borrowing Strategy for the year including:

- The Council's policy on the making of Minimum Revenue Provision (MRP) for the repayment of debt, as required by the Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008.

- The Affordable Borrowing Limit for the year as required by the Local Government Act 2003.

(ii) The Investment Strategy for the year as required by the CLG Guidance on Local Government Investments issued in 2004, and updated in 2010.

d) A mid-year review report and an annual review report of the previous year.

These documents are reported to Cabinet and Council as part of the budget setting process. The Council's Treasury Strategy for 2010-11 was approved by Council at its meeting on 25 February 2010.

4.1.2 The updated CIPFA Treasury Management Code of Practice, published in 2009, requires the Council to place greater emphasis on the scrutiny of treasury management strategies and policies. This includes the nomination of the body (such as an audit or scrutiny committee) responsible for ensuring effective scrutiny of the treasury management strategy, policies and practices. The Audit Committee has been nominated for this role, which includes the review of all treasury management policies and procedures, the review of all treasury management reports to Cabinet and Council, and for making recommendations to Council.

4.2 Resources and Risk

4.2.1 The resources required for the Council's debt management and debt financing budgets are agreed annually through the Council's budget setting process. The debt financing budget position as at 30 Sept is shown at paragraph 3.2.55 and Annex J.

4.2.2 The risk management of the treasury function is an integral part of day-to-day treasury activities. It is also specifically covered in the Council's Treasury Management Practices (TMPs), which are reviewed annually.

4.3 Legal

4.3.1 The Council is obliged to carry out its treasury management activities in line with statutory requirements and associated regulations and professional guidance. The relevant legislative and regulatory documents are referred to within the report and listed in the background papers.

4.4 Equality

4.4.1 An Equalities Impact Assessment was carried out on the Council's Treasury Strategy for 2010-11, and the associated Treasury Management Practices (TMPs) and the Schedules to the TMPs. This was included as an annex to the report to Cabinet on 24 February 2010 and to Council on 25 February 2010.

4.4.2 As a result of that assessment, it was noted that the potential impact of the strategy and associated documents (including Treasury Management Practices (TMPs) and the Schedules to the TMPs) on the different equalities groups must be considered as it is developed and put together each year. This includes the consideration of the potential impact on the different equalities groups of any processes, procedures or outcomes arising from these.

4.5 Consultees (Internal and External)

4.5.1 Consultation on treasury management matters is undertaken as appropriate with the Council's treasury advisers, Sector, and with the Portfolio holder for Finance.

4.5.2 Under new regulatory requirements, the Audit Committee has been nominated by Council as the body responsible for ensuring effective scrutiny of the treasury management strategy, policies and practices. This role includes the review of all treasury management policies and procedures, the review of all treasury management reports to Cabinet and Council, and the making of recommendations to Council. Audit Committee reviewed and noted the draft treasury management mid year report and annexes at their meeting on 8 November 2010.

4.6 How the Proposals deliver Priority Outcomes

4.6.1 The Council is required to keep its Treasury Management Strategy under review and monitor against it. The strategy should reflect the requirements of the CIPFA Code of Practice for Treasury Management in the Public Services.

4.6.2 This supports the Council's priority to be a well-managed organisation that puts our customers at the heart of what we do.

4.7 Other Implications

4.7.1 No other implications have been identified

5. Background Papers

Statute, Regulation and Guidance

CIPFA Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes 2001

Local Government Act 2003

Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

CIPFA Prudential Code for Capital Finance in Local Authorities 2003

ODPM Guidance on Local Government Investments 2004

CIPFA Treasury Management in the Public Services - Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (Fully Revised Second Edition 2006)

CIPFA Prudential Code for Capital Finance in Local Authorities – Fully Revised Guidance Notes for Practitioners 2007

Audit Commission. Risk & Return: English Local Authorities and the Icelandic Banking Crisis (March 2009)

CLG Select Committee report on Local Authority Investments (11 June 2009)

The Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008

CIPFA Prudential Code for Capital Finance in Local Authorities (Fully Revised Second Edition) 2009

CIPFA Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes (Fully Revised Second Edition) 2009

CIPFA Treasury Management in the Public Services - Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (Fully Revised Third Edition) 2009

CLG Guidance on Local Government Investments (11 March 2010)

Reports to Cabinet & Council

Treasury Strategy 2010-11 to 2012-13 – Report to Cabinet 24 February 2010 & Council 25 February 2010

Prudential Indicators for Capital Finance 2010-11 to 2012-13 – Report to Cabinet 24 February 2010 & Council 25 February 2010

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