Havering
LONDON BOROUGH

CABINET 26 October 2011	REPORT

Subject Heading:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report
Cabinet Member:	Cllr Roger Ramsey
CMT Lead:	Andrew Blake-Herbert
Report Author and contact details:	Mark White – Capital & Treasury Manager
Policy context:	The Council is required to receive a mid-year review on the Treasury Management Strategy Statement (TMSS) and the Annual Investment Strategy (AIS).
Financial summary:	There are no direct financial implications from this report. Treasury management activities are considered as part of the overall budget strategy.
Is this a Key Decision?	No
Is this a Strategic Decision?	Yes
When should this matter be reviewed?	Annual approval with bi-annual reviews. Additional reviews will be undertaken if required.
Reviewing OSC:	Audit Committee

The subject matter of this report deals with the following Council Objectives

Ensuring a clean, safe and green borough	[]
Championing education and learning for all	[]
Providing economic, social and cultural activity in thriving towns and villages	[]
Valuing and enhancing the lives of our residents	[X]
Delivering high customer satisfaction and a stable council tax	[X]

SUMMARY

This mid year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

- A review of the Treasury Management Strategy Statement and Annual Investment Strategy
- The Council's capital expenditure (prudential indicators)
- A review of the Council's investment portfolio for 2011/12
- A review of the Council's borrowing strategy for 2011/12
- A review of any debt rescheduling undertaken during 2011/12
- A review of compliance with Treasury and Prudential Limits for 2011/12

RECOMMENDATIONS

- Note the report, the treasury activity and recommend approval of the changes to the prudential indicators (including the changes set out in paragraph 2.2 and 2.3 relating to the HRA reform).
- Recommend approval of the changes to the investment criteria as set out at paragraph 1.2 to full Council.
- Note the expected impact on the capital and treasury plans of the HRA reform measures.
- Note that the decision to borrow to finance the HRA subsidy payment will be made by the group director for finance & commerce in consultation with the lead Member for value

REPORT DETAIL

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) has been adopted by this Council.

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 Committee.

1 Treasury Management Strategy Statement and Annual Investment Strategy update

1.1 The Treasury Management Strategy Statement (TMSS) for 2011/12 was approved by this Council as part of its annual budget setting process. The underlying TMSS approved previously requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out below:

1.2 Subject to statutory powers, the Council will be required to make a one off payment to the CLG to remove the HRA from the current housing subsidy system. This one off payment is compensation, ensuring the HRA will no longer make future annual payments to the CLG. It is expected that the overall impact will be beneficial to the Council. Whilst the legislative framework is not yet in place, by agreeing to these revised prudential indicators the Council is ensuring the necessary local requirements are in place well before the payment is required on the 28th March 2012. Members are therefore requested to approve the following key changes to the 2011/12 prudential indicators:

Prudential Indicator 2011/12	**Original £'000**	**Impact of HRA Reform £'000**	**Revised Prudential Indicator £'000**
Authorised Limit	£97,000	£200,000	£297,000
Operational Boundary	£77,000	£200,000	£277,000
Capital Financing Requirement	£58,757	£178,000	£236,757

1.3 The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity

1.4 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 the majority of investments short term, and only invest with highly credit rated financial institutions.

1.5 As a result of the Authorities strict lending criteria, the recent downgrade on the 7th October of many of the UK's leading banks, has meant many of the top UK banks, including the Authorities own bankers are now no longer eligible as approved counterparties. Because of the current economic climate and the uncertainties over many of the European countries, Members are therefore requested to approve the amendment of the investment strategy so that the Authority is able to continue to place deposits with the major UK clearing banks. To allow this it is proposed that the initial tranche of Institutions covered by the UK Government liquidity guarantee scheme* (subject to further market intelligence) be included as an eligible counterparty.

*The UK Government liquidity guarantee scheme allows banks to swap high quality securities for UK treasury bills to assist in liquidity

1.6 The above amendment to the investment strategy has been developed in consultation with our treasury advisers who already include all the banks covered by the above change on their suggested counterparty list.

2 The Council's Capital Position (Prudential Indicators)

2.1 HRA Reform

2.1.1 The proposed reform of the HRA subsidy arrangements are expected to take place on 28 March 2012. This will involve the Council paying funds to the CLG which will remove the Council from the HRA subsidy system. This will impact on both the capital structure of the Council (as the HRA Capital

Financing Requirement will rise by the size of the CLG payment), and the treasury management service will need to consider the funding implications for the borrowing. The Council's prudential indicators shown below highlight the position in relation to the original position, and the expected impact of the HRA reform payment is incorporated in the recommended prudential indicator changes in section 4. The new HRA Capital Financing Requirement will form a cap on any future HRA capital expenditure.

2.2 Changes to the Prudential Indicators for the Capital Financing Requirement (CFR) and the Operational Boundary

2.2.1 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.

	2011/12 Original Estimate £'000	Impact of HRA Reform £'000	2011/12 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement			
CFR – non housing	£41,288	£0	£41,288
CFR – housing	£17,469	£178,000	£195,469
Total CFR	**£58,757**	**£178,000**	**£236,757**
Prudential Indicator – Operational Boundary			
Borrowing	£75,000	£200,000	£275,000
Other long term liabilities*	£2,000	£0	£2,000
Total debt 31 March	**£77,000**	**£44,986**	**£277,000**

2.3 Limits to Borrowing Activity

2.3.1 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2011/12 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

	2011/12 Original Estimate £'000	Current Position £'000	2011/12 Revised Estimate £'000
Gross borrowing	£44,986	£44,986	£222,986
CFR(year end position)	£58,757	£58,757	£236,757

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

2.3.3 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	2011/12 Original Indicator	Impact of HRA Reform £'000	2011/12 Revised Indicator
Borrowing	£95,000	£200,000	£295,000
Other long term liabilities*	£2,000	£0	£2,000
Total	**£97,000**	**£200,000**	**£297,000**

3 Investment Portfolio 2010/11

3.1 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. 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 averse environment, investment returns are likely to remain low.

3.2 The Council held £83.9m of investments as at 30 September 2011 (£81.9m at 31 March 2011) and the investment portfolio yield for the first six months of the year is 1.35% against a budgeted rate of return of 1.06%

3.3 The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2011/12.

3.4 The Council's budgeted investment return for 2011/12 is £853k, and performance for the year to date is £188k above budget.

4 New External Borrowing:

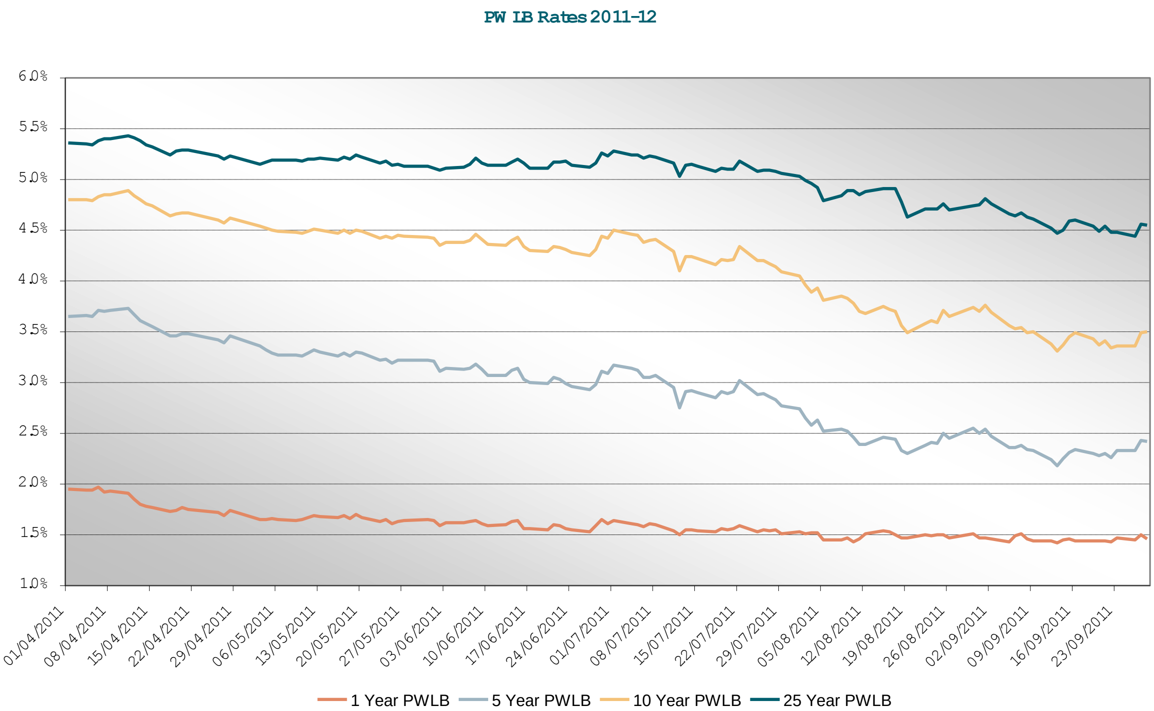
4.1 The Council's capital financing requirement (CFR) – *excluding HRA Reform* for 2011/12 is £58.7m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. Table 2.3 shows the Council has borrowings of £44.9m and has utilised £13.8m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

4.2 Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement - CFR), there has been no new external borrowing undertaken.

4.3 It is anticipated that new borrowing will not be undertaken during this financial year excluding any implications of the HRA reform.

4.4 The treasury service is currently analysing the options for the implications of the HRA reform impact. As the CLG will require payment on the 28 March 2012 of around £178m, a mix of loans and available cash resources will be used to pay this amount to ensure the overall position of the Council is safeguarded and the HRA and non-HRA are not disadvantaged.

4.5 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 etc:



5 Debt Rescheduling

5.1 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 2011/12.

IMPLICATIONS AND RISKS

Financial implications and risks:

There are no direct financial implications from this report.

Legal implications and risks:

There are no apparent legal implications or risks from this report

Human Resources implications and risks:

There are no HR implications from this report

Equalities implications and risks:

There are no Equalities implications arising from this report

BACKGROUND PAPERS

1 CIPFA Prudential Code

2 CIPFA Treasury Management Code of Practice

3 Treasury Management Strategy Statement and Annual Investment Strategy