Cheltenham Borough Council

Cabinet – 7th December 2010

Council - 13th December 2010

Treasury Mid Term Report 2010/11

Accountable member	**Finance & Community Development , John Webster**
Accountable officer	**Chief Finance Officer , Mark Sheldon**
Accountable scrutiny committee	**Economy & Business Improvement**
Ward(s) affected	**None**
Significant Decision	**No**
Executive summary	The Treasury Management Strategy for 2010/11 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority has adopted the code and complies with its requirements, one of which is the provision of a Mid-year Report to Members.
Recommendations	In compliance with the requirements of the CIPFA Code of Practice this report provides Members with a summary report of the treasury management activity during the first six months of 2010/11. Members are asked to note the report.

Financial implications	All financial implications are noted in the report **Contact officer: Andrew Sherbourne, andrew.sherbourne@cheltenham.gov.uk, 01242 264337**
Legal implications	None specific arising from the report recommendations. **Contact officer: Peter Lewis , peter.lewis@tewkesbury.gov.uk, 01242 264216**
HR implications (including learning and organisational development)	No direct HR implications arising from this report **Contact officer: Julie Mccarthy , Julie.mccarthy @cheltenham.gov.uk. 01242 264355**
Key risks	

Corporate and community plan Implications	
Environmental and climate change implications	

1. Background

The Treasury Management Strategy for 2010/11 has been determined by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year. The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority has adopted the code and complies with its requirements, one of which is the provision of a Mid-year Report to Members.

2. Economic update for the first six months

2.1 The following key points have been provided by the councils Treasury Advisors, Arlingclose Ltd.

The UK continued to emerge from the recession but the level of activity remained well below pre-crisis levels. Gross Domestic Product (GDP) registered 0.3% growth in the first quarter of 2010 and 1.2% in the second.

2.2 The Bank of England's Monetary Policy Committee (MPC) maintained the Bank Rate at 0.5% and Quantitative Easing at £200bn. However, the minutes of the Bank of England's September meeting contained the possibility of further Quantitative Easing to keep the economy and inflation on track in the medium term.

2.3 Annual CPI has remained high so far during 2010. It peaked at 3.7% in April and has fallen back to 3.2% in September. In the coming months higher food and fuel prices, coupled with the hike of VAT from 17.5% to 20%, will see inflation rise and we may not see inflation come down again until later in 2011.

2.4 The formation of a coalition government dispelled uncertainty surrounding a hung parliament in May's General Election. The new government's Emergency Budget laid out tough action to address the UK's budget deficit, aiming to eliminate the structural deficit by 2014/15. This is to be achieved through austerity measures - £32bn of spending cuts and £8bn of net tax increases.

2.5 Unemployment had been falling until July 2010. Since then, small increases in unemployment may indicate the start of a new trend of rising unemployment.

Portfolio position 1/4/2010 to 30/9/2010

Movements in the Council's borrowing during the first six months of 2010/11 financial year can be seen in the table below. Long term loans are deemed to be those repayable over a period of more than one year.

Source of Loan Temporary Borrowing	Balance at 1 April 2010 £	Raised during Apr-Sept £	Repaid during Apr-Sept £	Balance at 30 Sept 2010 £
- Building Societies	1,200,000	0	1,200,000	0
- Banks	0	0	0	
- Local Authorities	15,800,000	65,900,000	74,700,000	7,000,000
Temporary Investment	614,303	1,591,333	1,550,065	655,571
Total Short Term Borrowing	**17,614,303**	**67,491,333**	**77,450,065**	**7,655,571**
Long Term Borrowing				
- Public Works Loan Board	11,000,000	0	0	11,000,000
- Market Loans	15,900,000	0	0	15,900,000
Long Term Borrowing	**26,900,000**	**0**	**0**	**26,900,000**
Total External Borrowing	**44,514,303**	**67,491,333**	**77,450,065**	**34,555,571**

3.1 In February 2010 the Council's borrowing costs for 2010/11 was estimated to be £1,219,300. This is now forecast to be £1,212,600. Temporary borrowing of £65.9m at an average interest rate of 0.35% has occurred between 1st April and 30th September 2010 to meet temporary cash flow shortfalls.

This is lower than what was forecast in the 2010/11 Treasury Management Strategy as interest rates were expected to rise in the summer/autumn of this year. As a consequence the consolidated rate of interest estimated in December 2009 (4%) is now likely to be around 3.08% as the base rate is forecast to remain at 0.50% for a while longer. This may result in the HRA paying £175,300 less interest to the General Fund.

3.2 No debt rescheduling has been undertaken so far this financial year as the PWLB repayment rates make the premium costs payable too expensive. The Council's debt portfolio will continue to be reviewed by Arlingclose for debt rescheduling opportunities which has assisted us in the past.

4. Investments

The DCLG's Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy for 2010/11 approved by Council on the 12th February 2010. This restricted new investments to the following

- Debt Management Office (DMO)
- Other Local Authorities
- UK Banks – Minimum long term rating of A+ across all three rating agencies (Fitch, Standard & Poors and Moody's)
- *Other - Cheltenham Festivals/Gloucestershire Airport Company, Everyman Theatre and Cheltenham Borough Homes

* These were approved at Council on the 28th June 2010.

Counterparty credit quality is assessed and monitored with reference to :-

- Credit ratings
- Credit Default Swaps
- Share Price

Using Arlingclose's suggested creditworthiness approach in the current economic climate it is considered appropriate to keep investments short term.

4.1 Investments - Movements in the Council's investment portfolio during the first six months of 2010/11 can be seen in the table below.

Source of Loan **Temporary Lending**	**Balance at 1 April 2010 £**	**Raised during Apr-Sept £**	**Repaid during Apr-Sept £**	**Balance at 30 Sept 2010 £**
- Building Societies	0	0	0	0
- Banks	2,700,000	2,000,000	150,000	4,550,000
Bank of Scotland Call A/C	0	22,760,000	22,260,000	500,000
Debt Management Office	0	0	0	0
Total Short Term Lending	**2,700,000**	**24,760,000**	**22,410,000**	**5,050,000**
Long Term Lending	**Balance at 1 April**	**Raised during**	**Repaid during**	**Balance at 31 March**

	2009 £	the year £	the year £	2010 £
- Building Societies	0	0	0	0
- Banks	13,400,000	0	2,300,000	11,100,000
Total Long Term Lending	**13,400,000**	**0**	**2,300,000**	**11,100,000**
Total External Investments	**16,100,000**	**24,760,000**	**24,710,000**	**16,150,000**

4.2 In February 2010 the Council's Investment income for 2010/11 was estimated to be £243,200 but is now forecast to be £215,100, a reduction of £28,100. Interest rates were predicted to rise in September/October 2010 but this is now unlikely to happen with the economy as it stands and with rates looking to remain at 0.50% for the foreseeable future.

4.3 Included within the investments of £16.15m as at 30th September 2010, the Council has £9.65m deposited in the collapsed Icelandic banks. The Council has received £450,000 from the administrators of Kaupthing Singer & Friedlander in this financial year, which relates to 10p in the pound. A further distribution is expected in November/December 2010. The administrators currently estimate that total distributions should be in the range of 75p to 84p in the pound which is up from 65p to 78p as indicated in July 2010.

4.4 Following guidance from CIPFA, issued in September 2010, deposits held with Glitnir have been classed as non-priority claims by the Winding-Up-Board. Local authorities' legal advice remains that deposits have priority status under Icelandic law. If priority status is awarded 100% recovery is expected. If non-priority is awarded, recovery is expected to be 29%.

4.5 Landsbanki Winding-Up-Board has classed the Councils' deposits as priority claims. If priority status is awarded at court, 95% recovery is expected but if non-priority status is awarded, recovery is expected to be 38%. It is expected that the courts will come to the same conclusion for both Glitnir and Landsbanki. It is considered unlikely that there will be a settled position on priority status before the middle of the next financial year.

5. Compliance with Prudential Indicators

During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Annual Treasury Strategy Statement. In 2010/11 the Council set an authorised limit of £76m and an operational limit for borrowing of £69m, which was not breached during the financial year up until 30th September 2010.

6. Outlook

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Official Bank Rate										
Upside risk	-	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50
Central case	**0.50**	**0.50**	**0.50**	**0.75**	**1.00**	**1.25**	**1.50**	**2.00**	**2.50**	**2.75**
Downside risk	-	-	-	- 0.25	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50	- 0.50

6.1 The path of base rates reflects the fragility of the recovery and the significantly greater fiscal tightening of the emergency budget. The Bank of England will stick to its lower for longer stance on policy rates. Consumer Price Inflation is stubbornly above 3% and could remain higher that the

Monetary Policy Committee has previously forecast. The employment outlook remains uncertain, as unemployment remains near a 16 year high at just over 2.4 million.

7 Performance management

7.1 In compliance with the requirements of the Treasury Management CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first six months of 2010/11. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

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Appendices	1 – Risk Assessment
Background information	