Cheltenham Borough Council
Cabinet – 6th December 2011
Council - 12th December 2011
Treasury Mid-Term Report 2011/12

Accountable member	**Cabinet Member Finance & Community Development , Councillor John Webster**
Accountable officer	**Director Resources , Mark Sheldon**
Accountable scrutiny committee	**Economy & Business Improvement**
Ward(s) affected	**None**
Key Decision	**Yes**
Executive summary	The Treasury Management Strategy for 2011/12 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. The report has highlighted a need to change some of the Council's current Prudential Indicators and it is a requirement for Council to approve these changes. These are in respect of the additional HRA debt which the Council will be required to take on under the HRA Self Financing proposals. The proposed additional debt as set out in the Self-Financing consultation is for Cheltenham Borough Council to take on additional £27.881m.
Consultation	The Treasury Management Panel met to consider this report on 21st November 2011 and have made the following recommendations as indicated below.
Recommendations	**Members are requested to approve the following recommendations to Cabinet following consultation with the Treasury Management Panel on 21st November 2011:** **1. note the contents of the summary report of the treasury management activity during the first six months of 2011/12.** **2. approve the new limits set for the Authorised Borrowing Limit to £109m and the Operational Boundary for Borrowing for 2011/12 to £99m which takes into account the additional HRA debt allocation as detailed in section 5.**

Financial implications	All financial implications are detailed throughout 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

1.1 The Treasury Management Strategy for 2011/12 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.

1.2 The government are pushing through major changes which will have a big impact on the way the Housing Revenue Account (HRA) is financed in the future. The effect of theses changes are reflected in section 5 of this report.

2. Economic update for the first six months

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

2.2 Global growth prospects deteriorated considerably over the six months to September, moving from an expectation of modest growth to the risk of a double-dip recession. In the UK the first quarter growth was 0.5% and in the second quarter was 0.2%.

2.2 Inflation remained stubbornly high as the annual CPI was 4.5% in August 2011. The Bank of England believed the elevated rate of inflation reflected the temporary impact of several factors, the increase in the VAT rate to 20%, past increases in global energy prices and import prices.

2.3 Weakness persisted in the job market as unemployment rose to 7.9%. Job creation was unable to absorb the 90,000 quarterly increase in job seekers. With average earnings growth of 2.9%, scarce availability of credit, stagnant house prices, all combined to lower disposable income, squeezed household spending power and leaving consumer confidence fragile.

2.4 Central bankers' policies were driven by the feeble growth outlook rather than the upward trend in inflation. The Bank of England's August Inflation Report downgraded the growth forecast even as it acknowledged energy prices could push the annual CPI to 5% before inflation fell back to the 2% target over the medium-term. The UK's strategy of combining low interest rates for two and a half years and Quantitative Easing at £275bn with tight fiscal policy supported the rebalancing of the economy and also commanded support in the markets.

2.5 The European sovereign debt crisis deepened. The agreement in July to address Greece's economic problems and increase the mandate for the European Financial Stability Facility (EFSF) only bought time for the Eurozone as market pressure increased in Italy and Spain, but did little to address the issue of overburdened sovereign balance sheets.

2.6 The economic uncertainty resulted in analysts postponing the likelihood of an increase in the UK Bank Rate until late 2012.

3. Portfolio position 1/4/2011 to 30/9/2011

Movements in the Council's borrowing during the first six months of 2011/12 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 2011 £**	**Raised during Apr-Sept £**	**Repaid during Apr-Sept £**	**Balance at 30 Sept 2011 £**
- Building Societies	5,000,000	0	5,000,000	0
- Banks	0	0	0	0
- Local Authorities	8,000,000	68,540,000	65,840,000	10,700,000
Temporary Investment	323,759	774,419	1,055,878	42,300
Total Short Term Borrowing	**13,323,759**	**69,314,419**	**71,895,878**	**10,742,300**
Long Term Borrowing				
- Public Works Loan Board	11,000,000	1,400,000	3,792	12,396,208
- Market Loans	15,900,000	0	0	15,900,000
Long Term Borrowing	**26,900,000**	**1,400,000**	**3,792**	**28,296,208**
Total External Borrowing	**40,223,759**	**70,714,419**	**71,899,670**	**39,038,508**

3.1 In February 2011 the Council's borrowing costs for 2011/12 was estimated to be £1,212,600. This is now forecast to be £1,216,700. Temporary borrowing of £68.54m at an average interest rate of 0.40% has occurred between 1st April and 30th September 2011 to meet temporary cash flow shortfalls against a forecasted rate of 0.38%.

3.2 The calculation for the HRA Item 8 Debit last February estimated the consolidated rate of interest to be 3.08% on all borrowing for this financial year. However due to the council's weighted average borrowing estimated to be lower than the Capital Financing Requirement (CFR), which is a measure of the authorities underlying need to borrow for capital purposes, a different formula is required to calculate the HRA Item 8 Debit than what was used previously. This has reduced the consolidated rate of interest to around 2.80%. This could result in £46,900 less interest being payable by the HRA to the General Fund for 2011/12.

3.3 New borrowing of PWLB fixed rate loans increased by nearly 1% in October 2010 however the PWLB remained an attractive source of borrowing for the Council as it offers flexibility and control. The large downward move in gilt yields in the second quarter resulted in PWLB rates falling. The Council funded £1.4m of its capital expenditure on behalf of Cheltenham Borough Homes for the new homes built in Brighton Road. An annuity loan of 50 years was taken out at a rate of 4.52%. This is cost neutral to the General Fund as CBH are repaying the loan and interest payments. Further PWLB borrowing is forecast to occur again later in the financial year to fund the Everyman Theatre renovation and for further CBH new builds in the St. Paul's ward. An update on these loans will appear in the Outturn Report at year end.

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 2011/12 approved by Council on the 11th February 2011. This restricted new investments to the following

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

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 and more recently only up to six months for new investments.

4.1 **Investments -** Movements in the Council's investment portfolio during the first six months of 2011/12 can be seen in the table below.

Source of Loan **Short term Lending**	**Balance at 1 April 2011 £**	**Raised during Apr-Sept £**	**Repaid during Apr-Sept £**	**Balance at 30 Sept 2011 £**
- Building Societies	0	0	0	0
- Banks	7,000,000	2,000,000	2,000,000	7,000,000
Bank of Scotland Call A/C	900,000	40,250,000	41,150,000	0
Debt Management Office	0	0	0	0
Total Short Term Lending	**7,900,000**	**42,250,000**	**43,150,000**	**7,000,000**
Icelandic Banks In administration	**Balance at 1 April 2011 £**	**Raised during the year £**	**Repaid during the year £**	**Balance at 30 Sept 2011 £**
- Kaupthing Singer & Friedlander	1,410,000	0	150,000	1,260,000
- Glitnir	3,000,000	0	0	3,000,000
- Landsbanki	5,000,000	0	0	5,000,000
Total Icelandic Banks	**9,410,000**	**0**	**150,000**	**9,260,000**
Total External Investments	**17,310,000**	**42,250,000**	**43,300,000**	**16,260,000**

4.2 In February 2011 the Council's Investment income for 2011/12 was budgeted to be £175,700. The average cash balances representing the council's reserves and working balances, was £8.173m during the period. The UK Bank Rate has been maintained at 0.50% since March 2009 and is not expected to rise until late 2012 or beyond. The Council anticipates an investment outturn of £172,500 at a rate of 2.44% for the whole year. Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2011/12.

4.3 The lack of real progress in resolving the sovereign debt crisis in Europe began to affect even the stronger Eurozone nations and their banking systems. Having reviewed all credit indicators the Council, advised by Arlingclose, believed that there were no solvency issues with the banks on the recommended lending list however the share price moves were too sharp to ignore and a prudent response to the tensions and negativity in the markets was required. The Council responded to the advise given by Arlingclose by first scaling back maturities for any new investments and then as further advised by Arlingclose, suspending Clydesdale Bank, Lloyds Banking Group, Royal Bank of Scotland and Nationwide Building Society from the lending list in early October 2011 as those organisations did not meet the Council's minimum criteria of A+ or equivalent. The situation will be reviewed again in February 2012. .

4.4 Included within the investments of £16.26m as at 30th September 2011, the Council has £9.26m deposited in the collapsed Icelandic banks. The Council has received £150,000 from the administrators of Kaupthing Singer & Friedlander in the first half of this financial year, which relates to 5p in the pound and another 5p in the pound payment was received in October 2011. To date the Council has now received 63p in the pound. The administrators currently estimate that total distributions should be in the range of 78p to 86p in the pound.

4.5 Recently the Icelandic Supreme Court has upheld the District Court decision that the test cases involving Local Authority deposits with Landsbanki and Glitnir banks as having priority creditor status. This means that local authority deposits will be at the front of the queue when the Winding Up Boards (WUB's) of the two banks start to make the repayments. It is expected that we will receive back 98% of the Landsbanki deposits and a 100% of the Glitnir deposits.

5. Reform of Council Housing Finance

5.1 The government are pushing through major changes which will have a big impact on the way the Housing Revenue Account (HRA) is financed in the future. In its publication 'Implementing Self-Financing for Council Housing' issued in February 2011, the DCLG set out the rationale, methodology and financial parameters for the initiative. Subject to the Localism Bill receiving Royal Assent and a commencement order being passed, final self-financing determinations are expected towards the end of January 2012 and the proposed transfer date is 28th March 2012.

5.2 The self-financing model provides an indicative sustainable level of opening housing debt. As the Council's debt level generated by the model is higher than the Subsidy Capital Financing Requirement (SCFR), the Council will be required to pay the CLG the difference between the two, which is £27.881m as set out in the self-financing consultation paper issued on the 21st November 2011. This will require the Council to fund this amount in the medium term through external borrowing/internal resources. On the 20th September 2011, following an announcement by HM Treasury, the Public Works Loan Board (PWLB) confirmed that the interest rate offered to local authorities would be temporarily reduced to allow councils to borrow at lower levels for their one-off HRA reform settlement payment. This will enable the Council to borrow at around 13 basis points above the equivalent gilt yield (currently rates are 1% above the gilt yield) to fund the HRA transaction. These lower rates will only be available on 26th March 2012.

5.3 As a consequence of the increase in debt due in March 2012 it is necessary to increase the Prudential Indicators for 2011/12 for the Authorised Borrowing Limit from £81m to £109m and the Operational Boundary for Borrowing from £71m to £99m to comply with the Prudential Code. The Authorised Limit is the possible maximum level of borrowing that may be needed to be incurred and any limit above is prohibited. The amount set reflects a level of borrowing which, although affordable in the short term may not be sustainable. The Operational Boundary for external debt is based on the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit. This limit represents a key management tool for in year monitoring.

6. Prudential Indicators

6.1 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.

7. Outlook

7.1 At the time of writing this activity report in November 2011, given the precarious outlook for growth it is believed the Bank of England would only raise rates after there was firm evidence that the economy had survived the fiscal consolidation. Therefore, the outlook is for official interest rates to remain low for the foreseeable future.

	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
Official Bank Rate													
Upside risk	--	--	--	0.25	0.25	0.25	0.5	0.75	1	1.25	1.5	1.75	1.75
Central case	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Downside risk	--	--	--	--	--	--	--	--	--	--	--	--	--

8. Performance management

8.1 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 2011/12. 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	none
Background information	Treasury Management Strategy, Council February 2011