AGENDA ITEM NO. ……….

| ISLE OF ANGLESEY COUNTY COUNCIL | |
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| **REPORT TO** | **COUNTY COUNCIL** |
| **DATE** | **16 APRIL 2012** |
| **SUBJECT** | **TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY: MID-YEAR REVIEW REPORT 2012/13** |
| **LEAD OFFICER** | **HEAD OF FUNCTION (RESOURCES)** |
| **CONTACT OFFICER** | **EINIR WYN THOMAS (TEL: 2605)** |

**Nature and reason for reporting**

To comply with the recommendations of the CIPFA Code of Practice on Treasury Management.

The Council has resolved that this report is also considered by the Audit Committee. The Audit Committee considered the content of the report at its meeting on 12 December 2012 and resolved to accept its content and to refer it to the County Council.

## 1. Background

One of the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management is the receipt by the full council of a mid-year review report on treasury management activity. This report will fulfill that requirement, and covers the following:

- An economic update for the first six months, and looking forward to the second half, of 2012/13;
- 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 2012/13;
- A review of the Council's borrowing strategy for 2012/13;
- A review of any debt rescheduling undertaken during 2012/13;
- A summary of activity since quarter 2;
- A look ahead to next year; and
- A review of compliance with Treasury and Prudential Limits for 2012/13.

The County Council has resolved that the Audit Committee should take the role of scrutinising the reports on Treasury Management.

## 2. Economic Update

The Council's Treasury Advisers have recently provided a summary of the economic background and a short term outlook (Appendix 1) and also the following forecasts.

| | Dec 2012 | Mar 2013 | Jun 2013 | Sep 2013 | Dec 2013 | Mar 2014 | Jun 2014 | Sep 2014 | Dec 2014 | Mar 2015 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Bank Rate (%)** | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.75 |
| **5yr PWLB rate (%)** | 1.50 | 1.50 | 1.50 | 1.60 | 1.60 | 1.70 | 1.70 | 1.80 | 2.00 | 2.20 |
| **10yr PWLB rate (%)** | 2.50 | 2.50 | 2.50 | 2.60 | 2.60 | 2.70 | 2.70 | 2.80 | 3.00 | 3.20 |
| **25yr PWLB rate (%)** | 3.70 | 3.80 | 3.80 | 3.80 | 3.80 | 3.90 | 3.90 | 4.00 | 4.10 | 4.30 |
| **50yr PWLB rate (%)** | 3.90 | 4.00 | 4.00 | 4.00 | 4.00 | 4.10 | 4.10 | 4.20 | 4.30 | 4.50 |

During the quarter HM Treasury launched a discounted borrowing rate to provide cheaper PWLB borrowing to local authorities, effective from 1 November 2012. In order to be eligible for this ‘certainty rate’, which is 0.2% below the current standard rate, local authorities were required to submit specified information by a deadline of mid September 2012. This Authority complied with the requirements and is now eligible for this discounted rate, which is on a rolling annual basis. The above forecasts for PWLB rates incorporate this discount.

## 3. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2012/13 was approved by this Council on 6 March 2012. There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

## 4. The Council’s Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council’s capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

### 4.1 Prudential Indicator for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

| Capital Expenditure | 2012/13 Original Estimate £m | Position as at 30 September 2012 £m | 2012/13 Current Estimate £m |
|---|---|---|---|
| Council Fund | 18,000 | 4,483 | 18,000 |
| HRA | 9,800 | 4,664 | 9,800 |
| Total | 27,800 | 9,147 | 27,800 |

### 4.2 Changes to the Financing of the Capital Programme

There are no changes to the financing of the capital programme to report. The revenue contributions to the programme remain flexible and have been identified as a potential source of additional funding for the revenue budget.

### 4.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary

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.

**Prudential Indicator – Capital Financing Requirement**

We are on target to be within the original forecast Capital Financing Requirement.

**Prudential Indicator – External Debt / the Operational Boundary**

| | 2012/13 Original Estimate £m | Position as at 30 September 2012 £m | 2012/13 Revised Estimate £m |
|---|---|---|---|
| ***Prudential Indicator – Capital Financing Requirement*** | | | |
| CFR – Council Fund | 85,300 | 76,162 | 82,078 |
| CFR – HRA | 28,400 | 21,421 | 26,755 |
| Total CFR | 113,700 | 97,584 | 108,833 |
| Net movement in CFR | 13,034 | (16,116) | 8,167 |
| ***Prudential Indicator – External Debt / the Operational Boundary*** | | | |
| Borrowing | 118,000 | 96,100 | 96,096 |
| Other long term liabilities | 2,000 | Nil | Nil |
| Total debt 31 March | 120,000 | 96,100 | 96,096 |

## 4.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) 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 2012/13 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.

| | 2012/13 Original Estimate £m | Position as at 30 September 2012 £m |
|---|---|---|
| Gross borrowing | 113,717 | 96,100 |
| Plus other long term liabilities | Nil | Nil |
| Less investments | 25,932 | 22,100 |
| Net borrowing | 87,785 | 74,000 |
| CFR | 113,700 | 97,584 |

By the end of the year the CFR is projected to be £109m, and there is a borrowing requirement of £13m as a result. The option to internalise is still available, but it is likely the PWLB borrowing is a more attractive route as a result of the new Certainty Rate. Borrowing at year end will therefore be in the range £96m to £109m.

The Chief Financial Officer reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

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 | 2012/13 Original Indicator (£m) | Position as at 30 September 2012 (£m) |
|---|---|---|
| Borrowing | 123,000 | 96,100 |
| Other long term liabilities | 2,000 | Nil |
| Total | 125,000 | 96,100 |

## 5. Investment Portfolio 2012/13

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 when balanced with the associated risk. As set out in Section 3, 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 adverse environment, investment returns are likely to remain low.

The Council held £22m of investments as at 30 September 2012 (£16m at 31 March 2012) and the investment portfolio yield for the first six months of the year is 0.96%.

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2012/13.

The Council's budgeted investment return for 2012/13 is £0.4m. As indicated in the strategy, some borrowing has been internalised and so, during the year, the projected investment returns are below those budgeted for. However, there have been corresponding savings on loan interest and the forecast net outturn is within budget.

**Investment Counterparty criteria**

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function although it is becoming more difficult to place funds as the credit quality of counterparties continues to be reduced.

During the year the list of counterparties with suitable credit ratings continued to reduce substantially, with credit ratings across the board continuing to suffer and opportunities for investment continuing to narrow.

Deposits continue to be made with Santander UK plc consistent with the decision made by the County Council in March 2012 and endorsed by the Audit Committee. The current position is the short term ratings for two of the three agencies have fallen to one category below the normal approved list level. Long term ratings continue to be below the level of the approved list.

## 6. Borrowing

The increase in the Council's capital financing requirement (CFR) for 2012/13 is £8.2m. 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. The table at paragraph 4.4 shows the Council has borrowings of £96m and has utilised £1.5m of cash flow funds in lieu of borrowing. This is a prudent and cost effective approach in the current economic climate.

As outlined below, the general trend has been a reduction in interest rates during the six months, across all maturity bands.

We are currently internalising our borrowing due to current market conditions and interest rates and we are not intending talking out any new PWLB during the year. However, this strategy is flexible to market conditions, which continue to be monitored on a regular basis.

**7. Debt Rescheduling**

No debt rescheduling was undertaken during the first six months of 2012/13.

**8. Activity Since Quarter Two**

Since the end of the quarter a 6 month, £5m, fixed term investment with the Royal Bank of Scotland matured and this was re-invested with the bank for 364 days at a rate of 1.58%. No other fixed term investments were made and no new borrowing nor debt rescheduling has taken place. In October Member training on treasury management issues was undertaken in order to support the scrutiny role of members of the Audit Committee.

**9. Plans for next year**

At its next meeting in February, the Audit Committee will consider the plans for borrowing and investment for the forthcoming period. The initial plans, according to the current strategy are:

- to use the available general supported borrowing allocation of £2.142m (£2.689m in 2012/13) plus any unused current year allocation;
- to use the Local Government Borrowing Initiative supported borrowing in full; and
- to consider a proposal to borrow £5m a year in unsupported borrowing to enable the asset rationalisation programme including 21st Century Schools.

**10. Recommendation**

That the County Council notes the contents of this report, which have been scrutinised by the Audit Committee.

**EINIR WYN THOMAS**
**HEAD OF SERVICE (FINANCE)** **14 MARCH 2013**

**Rhagolygon Economaidd / Economic Update**

***Economic Performance to date***

Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. It was noted that the UK economy is heavily influenced by worldwide economic developments, particularly in the Eurozone, and that on-going negative sentiment in that area would inevitably permeate into the UK's economic performance.

With regard to the Eurozone, investor confidence remains weak because successive "rescue packages" have first raised, and then disappointed, market expectations. However, the uncertainty created by the continuing Eurozone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China.

In the UK, consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking a toll. Whilst inflation has fallen considerably (CPI @ 2.6% in July), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession. This means that the UK's recovery from the initial 2008 recession has been the worst and slowest of any G7 country apart from Italy (G7 = US, Japan, Germany, France, Canada, Italy and UK). It is also the slowest recovery from a recession of any of the five UK recessions since 1930 and total GDP is still 4.5% below its peak in 2008.

This weak recovery has caused social security payments to remain elevated and tax receipts to be depressed. Consequently, the Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed back further into the future. The Monetary Policy Committee has kept Bank Rate at 0.5% throughout the period while quantitative easing was increased by £50bn to £375bn in July. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested in and gilt yields, prior to the ECB bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

***Outlook for the second half of 2012/13***

The risks in economic forecasts continue unabated from the previous treasury strategy. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is hamstrung by political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required early in 2013 to address the US debt position. However, on 13 September the Fed. announced an aggressive stimulus programme for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid 2015.

Eurozone growth will remain weak as austerity programmes in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it has failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. There is the distinct possibility that some of the northern European countries could push for the ejection of Greece from the Eurozone unless its financial prospects improve, which does not seem likely at this juncture. A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the ECB announced that it would purchase unlimited amounts of shorter term bonds of Eurozone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions (which have yet to be set) and include supervision from the International Monetary Fund. This resulted in a surge in confidence that the Eurozone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether the politicians in charge of Spain and Italy will accept such loss of sovereignty in the light of the verdicts that voters have delivered to the politicians in other peripheral countries which have accepted such supervision and austerity programmes. The Eurozone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous "solutions" to the Eurozone crisis.

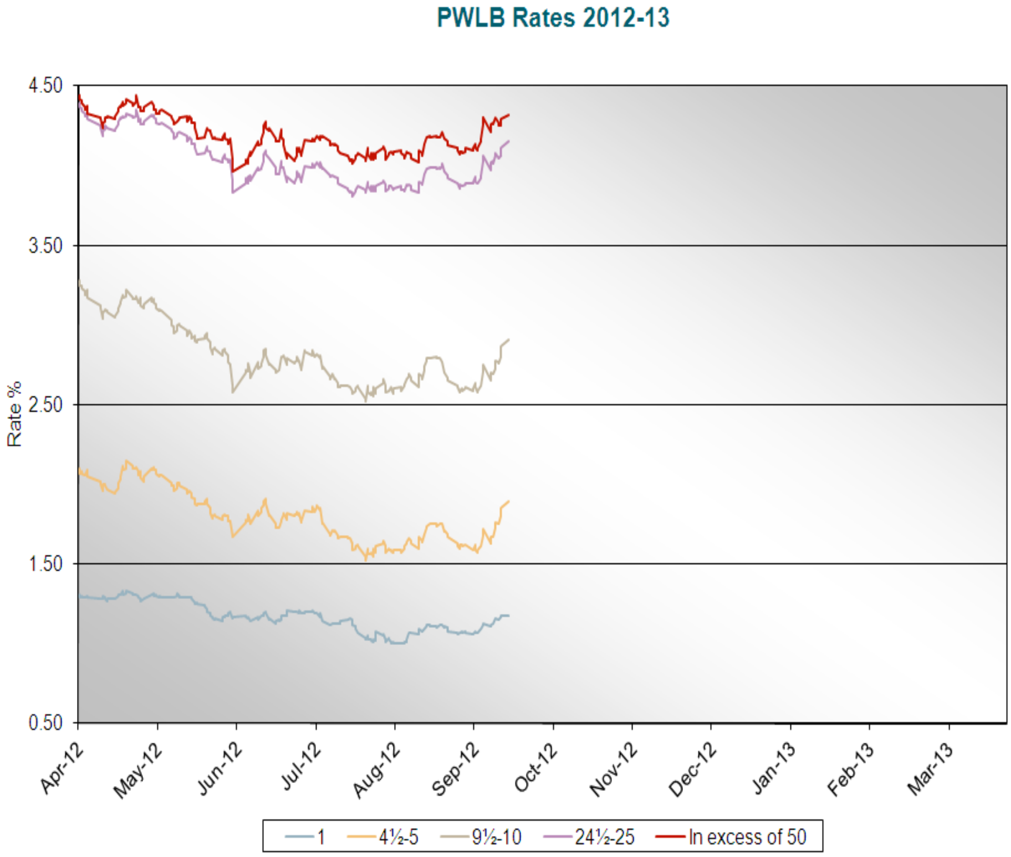
The Bank of England Quarterly Inflation Report in August pushed back the timing of the return to trend growth and also lowered its inflation expectations. Nevertheless, concern remains that the Bank's forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world headwinds the UK economy faces. Weak export markets will remain a drag on the economy and consumer expenditure will continue to be depressed due to a focus on paying down debt, negative economic sentiment and job fears. The Coalition Government, meanwhile, is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

The overall balance of risks is, therefore, weighted to the downside:

- We expect low growth in the UK to continue, with Bank Rate unlikely to rise in the next 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to eventually rise, primarily due to the need for a high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, tempering any increases in yield.
- This interest rate forecast is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Eurozone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.

***Allan o gyngor gan / From advice from SECTOR Ltd***

The graph and table above show the movement in PWLB rates for the first six months of the year (to 10 September 2012).




| | 1 | 1-1.5 | 2.5-3 | 3.5-4 | 4.5-5 | 9.5-10 | 24.5-25 | 49.5-50 | GBR 1mnth | |
|---|---|---|---|---|---|---|---|---|---|---|
| High | 1.330% | 1.400% | 1.690% | 1.910% | 2.150% | 3.250% | 4.370% | 4.430% | 1.500% | High |
| Dates | 20/04/2012 | 20/04/2012 | 20/04/2012 | 20/04/2012 | 20/04/2012 | 02/04/2012 | 02/04/2012 | 24/04/2012 | 18/04/2012 | Dates |
| Low | 1.000% | 1.030% | 1.170% | 1.320% | 1.520% | 2.520% | 3.810% | 3.960% | 1.450% | Low |
| Dates | 02/08/2012 | 02/08/2012 | 23/07/2012 | 23/07/2012 | 23/07/2012 | 23/07/2012 | 18/07/2012 | 01/06/2012 | 01/08/2012 | Dates |
| Average | 1.171% | 1.211% | 1.410% | 1.592% | 1.801% | 2.816% | 4.032% | 4.190% | 1.478% | Average |
| Spread | 0.330% | 0.370% | 0.520% | 0.590% | 0.630% | 0.730% | 0.560% | 0.470% | 0.050% | Spread |

***Allan gan / From SECTOR Ltd***

APPENDIX 3

## Borrowing and Investment Summary – Quarters 1 and 2 2012/13

| | 30 Sept 2012 | | 30 June 2012 | |
|---|---|---|---|---|
| | £m | % | £m | % |
| Borrowing – fixed rate | 96.1 | 5.53 | 96.1 | 5.53 |
| Borrowing – variable rate | - | - | - | - |
| Deposits – Call to 30 days | 12.1 | 0.76 | 14.0 | 0.76 |
| Deposits – Fixed Term < 1 year | 10.0 | 1.42 | 10.0 | 1.42 |
| Deposits – Fixed Term 1 year + | - | - | - | - |
| Total Deposits | 22.1 | 1.06 | 24.0 | 1.03 |
| Average Deposits in the Quarter | 27.9 | - | 26.8 | - |

## Prudential and Treasury Indicators – Quarter 2 2012/13

| Prudential / Treasury Indicator | 2012/13 Indicator £m | Quarter 2 - Actual £m |
|---|---|---|
| Capital Financing Requirement (CFR) | 113.7 | n/a |
| Gross borrowing | n/a | 96.1 |
| Investments | n/a | 22.1 |
| Net borrowing | n/a | 74.0 |
| Authorised limit for external debt | 123 | Within limit |
| Operational boundary for external debt | 118 | Within limit |
| Limit of fixed interest rates based on net debt | 105 | Within limit |
| Limit of variable interest rates based on net debt | 20 | Nil |
| Principal sums invested > 364 days | 15 | Nil |
| Maturity structure of borrowing limits | | |
| Under 12 months | 20% | 0% |
| 12 months to 2 years | 20% | 7% |
| 2 years to 5 years | 50% | 6% |
| 5 years to 10 years | 75% | 15% |
| 10 years and above | 100% | 72% |