ANNEX A: Treasury Management Strategy Statement and Annual Investment Strategy – Mid-year Review Report 2011/12

1. Background

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation is to ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate security initially before considering liquidity issues and seeking to maximise investment return.

As a consequence treasury management is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

2. Introduction

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 15th February 2010.

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 Executive and Resources PDS Committee.

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

- An economic update for the first six months of 2011/12;
- 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 compliance with Treasury and Prudential Limits for 2011/12.

3. Economic update

3.1 Global economy

The Euro zone sovereign debt crisis continued with Spain, and particularly Italy, being the focus of renewed market concerns that they may soon join with Greece, Ireland and Portugal in needing assistance. This uncertainty and the lack of a co-ordinated or credible Euro zone response left commentators concerned over the potential impact of sovereign default and the resulting effect on the Euro zone banking sector. The approval by various countries of the €440bn bail out fund in September has brought temporary relief to financial markets but this does not provide a credible remedy to the scale of the Greek debt problem or the sheer magnitude of the potential needs of other countries for support.

This, coupled with political difficulties in the US over their plans to address the budget deficit, the size and control over the US sovereign debt and the subsequent loss of the AAA credit rating from Standard and Poor's, has led to a much more difficult and uncertain outlook for the world economy. Growth prospects in the US, UK and the euro zone have been lower than expected, with future prospects similarly cut. Whilst not a central view, concerns of a double dip recession in some Western countries have increased. World stock markets fell in the second quarter of 2011/12 as a consequence.

3.2 UK economy

Following zero growth in the final half of 2010/11, the UK economy grew by a weaker than expected 0.1% in the first quarter of 2011/12, providing a knock-on effect to future growth prospects. Growth prospects will be governed by UK consumer sentiment, which is currently subdued due to falling disposable income. Higher VAT, overhanging debt, high inflation and concerns over employment are likely to weigh heavily on consumers into the future.

The announcement by the MPC on 6th October of a second round of quantitative easing of £75bn emphasised how seriously the MPC now views recession as being a much bigger concern than inflation. Although inflation remains stubbornly high, the MPC's expectation of future falls resulting in an undershoot of its 2% target opened the way for this new round of QE.

International investors continue to view UK government gilts as being a safe haven from the EU sovereign debt crisis. The consequent increase in demand for gilts has helped to add downward pressure on gilt yields and sent PWLB borrowing rates to low levels.

3.3 Outlook for the next six months of 2011/12

There remain huge uncertainties in economic forecasts due to the following major difficulties:

- the increase in risk that the UK, US and EU could fall into recession;
- the likely political gridlock in the US preventing significant government fiscal action to boost growth ahead of the Presidential elections in November 2012;
- the potential for a major EU sovereign debt crisis, which could have a significant impact on financial markets and the global and UK economies;
- the degree to which government austerity programmes will dampen economic growth;
- the potential for further quantitative easing, and the timing of this in both the UK and US;
- the speed of recovery of banks' profitability and balance sheet imbalances and the risk of substantial losses being incurred on EU sovereign debt.

The overall balance of risks is weighted to the downside:

- Low growth in the UK is expected to continue, with a low Bank Rate to continue for at least 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 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, postponing any increases until 2012.

3.4 Sector’s interest rate forecast

	NOW	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	**Mar-15**
BANK RATE	0.50	0.50	**0.50**	0.50	0.50	0.50	**0.50**	0.50	0.75	1.00	**1.25**	1.50	2.00	2.25	**2.50**
3 month LIBID	0.75	0.70	**0.70**	0.70	0.70	0.70	**0.75**	0.80	0.90	1.20	**1.40**	1.60	2.10	2.40	**2.60**
6 month LIBID	1.00	1.00	**1.00**	1.00	1.00	1.00	**1.10**	1.20	1.40	1.60	**1.80**	2.00	2.50	2.70	**2.90**
12 month LIBID	1.50	1.50	**1.50**	1.50	1.50	1.60	**1.70**	1.80	1.90	2.20	**2.40**	2.60	3.10	3.20	**3.30**
5 yr PWLB	2.30	2.30	**2.30**	2.30	2.30	2.40	**2.50**	2.60	2.70	2.80	**2.90**	3.10	3.30	3.50	**3.70**
10 yr PWLB	3.30	3.30	**3.30**	3.30	3.40	3.40	**3.50**	3.60	3.70	3.80	**4.00**	4.20	4.40	4.60	**4.80**
25 yr PWLB	4.20	4.20	**4.20**	4.20	4.30	4.30	**4.40**	4.50	4.60	4.70	**4.80**	4.90	5.00	5.10	**5.20**
50 yr PWLB	4.30	4.30	**4.30**	4.30	4.40	4.40	**4.50**	4.60	4.70	4.80	**4.90**	5.00	5.10	5.20	**5.30**

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2011/12 was approved by this Council on 28th February 2011. There are no policy changes to the TMSS, the details in this report update the position in the light of actual performance activity to date in 2011/12 and the updated economic position.

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

- Security of capital
- Liquidity

The Council will also aim to achieve the optimum return (yield) on investments commensurate with the proper levels of security and liquidity. The current counterparty eligibility criteria permit maximum loan periods ranging from 3 months to 1 year for most institutions and 2 years for the partly government-owned Lloyds TSB and RBS. In the current economic climate, however, it is considered appropriate to keep investments short to medium term and the Finance Director is currently restricting investments to no longer than one year for the part-government owned banks and between 3 and 6 months for other banks on the Council’s approved lending list. This list only includes financial institutions with good credit ratings, with consideration also given to sovereign credit rating and credit default swap (CDS) overlay information provided by Sector, our external advisers.

Investments during the first six months of the year have been in line with the strategy, and there have been no deviations from the strategy.

As outlined in Section 3 above, there is still considerable uncertainty and volatility in the financial and banking market, both globally and in the UK. Credit rating downgrades since late-2008 have caused the Council’s approved lending list to diminish significantly, which has resulted in difficulties in identifying investment counterparties. Various changes to approved maximum lending periods and amounts since then have helped to generate returns in line with or better than budget, but it has to be stressed that security of principal will always be the main concern. It is important to be aware, however, that there is no such thing as a guaranteed safe investment, but some assurance should be taken from the fact that Council staff work to a strict set of criteria for lending and that compliance is always ensured. The Council receives advice and information from Sector Treasury Services and they have confirmed that the approach adopted by Bromley is prudent and reasonable. They have also supported an increase in the maximum lending limits for Lloyds TSB and RBS (from £40m to £60m), although this was considered but not approved by the Executive on 19th October 2011.

5 Investment Portfolio 2011/12

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. As is 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 environment, investment returns are likely to remain low. The Council's budgeted net investment return for 2011/12 is £2.7m and performance for the year to date is broadly in line with the budget, although it is currently estimated that we could reverse £700k of the Icelandic bank deposit impairment (see para 3.10 of the covering report).

Excluding the Heritable Icelandic deposit, the Council held £188.2m of investments as at 30th September 2011 (£168.4m at 31 March 2011) and the investment portfolio yield for the first six months of the year is 1.86% against the average 3-month LIBID rate of 0.72%. The average level of funds available for investment purposes in the first six months of 2011/12 was £203.0m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

The covering report includes details of the investment portfolio yield for the first six months of the year and a full list of investments held as at 30th September 2011 is attached at Appendices 1 and 2 of the main report. Officers confirm that the approved limits within the Annual Investment Strategy were not breached during the first six months of 2011/12.

6 External Borrowing

Borrowing rates have remained low during the first six months of the 2011/12 financial year. The Council does not borrow long-term to finance capital expenditure and, in the first half-year, there was no short-term borrowing to cover cashflow shortages.

7 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.

7.1 Prudential Indicators for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the Capital Programme for 2011/12 was agreed in February 2011. The increase in the latest estimate for 2011/12 is mainly the result of the significant level of slippage in expenditure planned for 2010/11, which has been highlighted in previous reports.

Capital Expenditure by Portfolio	2011/12 Original Estimate £m	2011/12 Revised Estimate £m
Children & Young People	25.8	39.9
Renewal & Recreation	6.5	7.6
Environment	4.8	7.2
Adult & Community Services	10.9	13.2
Resources	4.4	4.2
Add: service investment priority fund	2.5	2.0
Less: estimated slippage	-5.0	-10.0
Total	49.9	64.1

7.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure.

Capital Expenditure	2011/12 Original Estimate £m	2011/12 Revised Estimate £m
Supported	49.9	64.1
Unsupported	0.0	0.0
Total spend	**49.9**	**64.1**
Financed by:		
Capital receipts	12.3	15.9
Capital grants	23.4	30.4
Other external contributions	10.0	16.5
Revenue contributions	4.2	1.3
Total financing	**49.9**	**64.1**
Borrowing need	**0.0**	**0.0**

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

It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits", which comprise external / internal borrowing and other long-term liabilities, mainly finance leases. The Council's approved Treasury and Capital Prudential Indicators (affordability limits) are outlined in the approved TMSS. The table below shows the expected "worst case" debt position over the period. This is termed the Operational Boundary. Bromley has an operational "borrowing" limit (Operational Boundary) of £30m, although in practice, this limit is never in danger of being breached.

The Authorised Limit, which represents the limit beyond which borrowing is prohibited, is another of the prudential indicators 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 and, for Bromley, this figure has been set at £60m.

The table also shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. The Council's capital financing requirement (CFR) for 2011/12 is £7.4m.

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 Council's CFR has arisen from a combination of the internal "loan" made to the schools' budget to finance capital expenditure on special education (£3.1m) and liabilities arising from finance leases entered into in recent years in respect of various items of plant and equipment (£4.3m). The Council currently has no external borrowing as such. We are on target to achieve the original forecast Capital Financing Requirement for 2011/12.

Prudential Indicators	**2011/12 Original Estimate £m**	**2011/12 Revised Estimate £m**
CFR	**4.4**	**7.2**
Debt – Operational Boundary		
Borrowing	10.0	10.0
Other long-term liabilities	20.0	20.0
Total Operational Boundary	**30.0**	**30.0**
Debt – Authorised Boundary		
Borrowing	30.0	30.0
Other long-term liabilities	30.0	30.0
Total Operational Boundary	**60.0**	**60.0**

During the financial year to date the Council has operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in Annex B.

8 Other

Investment with Icelandic Bank
An update is provided in paragraph 3.10 of the covering report.

ANNEX B Prudential and Treasury Indicators

Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The revised Code (published in 2009) was adopted by full Council on 15th February 2010.

PRUDENTIAL INDICATORS	2010/11	2011/12	2011/12	2012/13	2013/14
	actual	estimate	probable	estimate	estimate
	£m	£m	£m	£m	£m
Total Capital Expenditure	£47.8m	£49.9m	£64.1m	£25.9m	£13.9m
Ratio of financing costs to net revenue stream	-2.6%	-1.3%	-1.3%	-1.5%	-2.0%
Net borrowing requirement (net investments for Bromley)					
brought forward 1 April	£133.9m	£134.5m	£161.0m	£141.6m	£143.9m
carried forward 31 March	£161.0m	£124.3m	£141.6m	£143.9m	£140.9m
in year borrowing requirement (movement in net investments for Bromley)	+£27.1m	-£10.2m	-£19.4m	+£2.3m	-£3.0m
Capital Financing Requirement as at 31 March	£7.4m	£4.4m	£7.2m	£6.9m	£6.6m
Annual change in Cap. Financing Requirement	+£3.9m	-£3.0m	-£0.2m	-£0.3m	-£0.3m
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	-	-	-	-	-

TREASURY MANAGEMENT INDICATORS	2010/11	2011/12	2011/12	2012/13	2013/14
	actual	estimate	probable	estimate	estimate
	£m	£m	£m	£m	£m
Authorised Limit for external debt -					
borrowing	£30.0	£30.0	£30.0	£30.0	£30.0
other long term liabilities	£30.0	£30.0	£30.0	£30.0	£30.0
TOTAL	£60.0	£60.0	£60.0	£60.0	£60.0
Operational Boundary for external debt -					
borrowing	£10.0	£10.0	£10.0	£10.0	£10.0
other long term liabilities	£20.0	£20.0	£20.0	£20.0	£20.0
TOTAL	£30.0	£30.0	£30.0	£30.0	£30.0
Actual external debt	£4.3	£10.0	£10.0	£10.0	£10.0
Upper limit for fixed interest rate exposure	100%	100%	100%	100%	100%
Upper limit for variable rate exposure	20%	20%	20%	20%	20%
Upper limit for total principal sums invested beyond year-end dates	£168.4	£134.3	£148.8	£150.8	£147.5