

PART 1 - PUBLIC

Decision Maker: Resources Portfolio Holder
Full Council

Date: For pre-decision scrutiny by the Executive and Resources PDS
Committee on 18th October 2012
Council 12th November 2012

Decision Type: Non-Urgent Executive Non-Key

Title: TREASURY MANAGEMENT - MID-YEAR REVIEW REPORT
2012/13

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Chief Officer: Director of Resources

Ward: All

1. Reason for report

- 1.1 CIPFA (the Chartered Institute of Public Finance and Accountancy) issued the latest Code of Practice for Treasury Management in 2011; it recommends that members should be updated on treasury management activities at least twice a year, but preferably more frequently. This report summarises treasury management activity during the period 1st April 2012 to 30th September 2012 and includes a Mid-Year Review of the Treasury Management Strategy Statement and Annual Investment Strategy (Annex A). The report ensures that the Council is implementing best practice in accordance with the Code and includes an update on the Council's investment with Heritable Bank (paragraph 3.12). It also provides a general update on interest rates and on the current economic climate and proposes changes to the investment criteria that form part of the Council's Annual Investment Strategy in the form of the inclusion of corporate bonds and the Payden Sterling Reserve Fund as eligible investment vehicles (see paragraphs 3.18 to 3.25). These changes will require the approval of full Council. Investments as at 30th September 2012 totalled £212.1m (excluding the balance of the Heritable investment) and there was no outstanding external borrowing.

RECOMMENDATION(S)

The PDS Committee and the Portfolio Holder are requested to:

- (a) Note the report;

- (b) Recommend to Council that the inclusion of corporate bonds and the Payden Sterling Reserve Fund as eligible investment vehicles in the Council's Investment Strategy be approved (see paragraphs 3.18 to 3.25); and**
- (c) Recommend that Council approve the changes to the prudential indicators, as set out in Annex B1.**

Council is requested to:

- (a) Note the report;**
- (b) Consider comments from the PDS Committee;**
- (c) Approve the inclusion of corporate bonds and the Payden Sterling Reserve Fund as eligible investment vehicles in the Council's Investment Strategy; and**
- (d) Approve changes to the prudential indicators, as set out in Annex B1.**

Corporate Policy

1. Policy Status: Existing policy. To seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.
 2. BBB Priority: Excellent Council.
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Financial

1. Cost of proposal: N/A
 2. Ongoing costs: N/A.
 3. Budget head/performance centre: Interest on balances
 4. Total current budget for this head: £2.691m (net) in 2012/13; currently forecast on target
 5. Source of funding: Net investment income
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Staff

1. Number of staff (current and additional): 0.4 fte
 2. If from existing staff resources, number of staff hours:
-

Legal

1. Legal Requirement: Non-statutory - Government guidance.
 2. Call-in: Call-in is applicable Changes to the Annual Investment Strategy require Council approval
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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a
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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.
2. Summary of Ward Councillors comments:

3. COMMENTARY

General

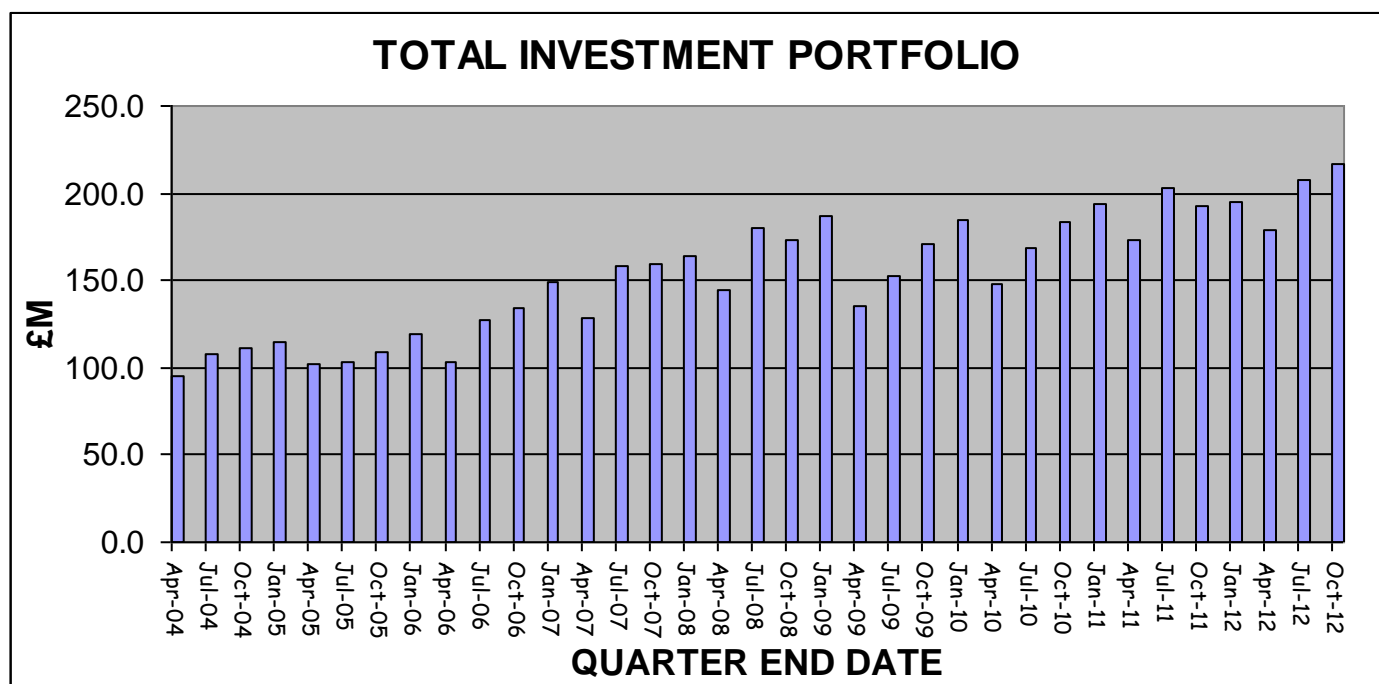
- 3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year describing the activity compared to the strategy. In practice, the Finance Director has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year-end. The 2012/13 annual strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was approved by the Council in February 2012.
- 3.2 This report includes details of treasury management activity during the first half of the financial year 2012/13 and details of investments in place as at 30th September 2012 (Appendices 1 and 2). A mid-year review of performance against the strategy for 2012/13 is attached at Annex A and this includes an update from our external advisers, Sector Treasury Services Ltd, on the economic background in the first half year and their latest interest rate forecast. Changes to prudential indicators requiring the approval of full Council are set out in Annex B. Changes to the strategy are proposed to permit investments in corporate bonds and in the Payden Sterling Reserve Fund (paragraphs 3.18 to 3.25) and the PDS Committee and Resources Portfolio Holder are asked to recommend these changes to full Council.
- 3.3 Recent changes in the regulatory environment place a much greater onus on Members to review and scrutinise treasury management policy and activities. This report is important in that respect, as it provides details of treasury activities in the first 6 months of 2012/13 and highlights compliance with the Council's policies previously approved by Members. The Finance Director confirms that the Council has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Executive and Resources PDS Committee before they were reported to full Council.

Treasury Performance in the half year 1st April 2012 to 30th September 2012

- 3.4 **Borrowing:** The Council's healthy cashflow position continued through the whole of 2011/12 and the first half of 2012/13, as a result of which no borrowing was required at all during those periods. In 2009/10, only four loans were taken out to cover short-term cashflow shortages and, in 2010/11, only one small overnight loan (for £800k) was taken out (in March 2011).
- 3.5 **Investments:** The following table sets out details of investment activity during the first six months of the year:-

Main investment portfolio	Deposits £m	Ave. Rate %
"Core" investments as at 31/03/12	152.5	2.23
Investments made in Q1 2012/13	36.5	1.75
Investments redeemed in Q1 2012/13	-59.0	1.28
Investments made in Q2 2012/13	22.5	1.23
Investments redeemed in Q2 2012/13	-12.5	1.59
Total "Core" Investments 30/09/12	140.0	2.05
35-day notice – Svenska Handelsbanken	15.0	0.85
Money Market Funds/Instant Access	57.1	0.58
Total Investments as at 30/09/12	212.1	1.57
Heritable deposit – frozen (see para 3.12)	5.0	6.42

- 3.6 Details of the outstanding investments at 30th September 2012 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. The average return on all new “core” investments during the first six months of the year was 1.59% which may be compared with the average 3 month LIBID rate of 0.74% and the average 7 day rate of 0.43%.
- 3.7 Base rate has now been 0.5% since March 2009 and the recently updated forecast by Sector is for it to remain at that level until the end of 2014. This estimate has slipped back a year in the space of the last 4 or 5 months and it is possible that it will slip further. Reports to previous meetings, most recently to the July meeting, have highlighted the fact that options with regard to the reinvestment of maturing deposits have become seriously limited due to bank credit rating downgrades. Changes to lending limits and eligibility criteria have in the past been temporarily successful in alleviating this, but we are now back in the position of not having many investment options other than placing money with instant access accounts at relatively low interest rates. Active UK banks on our list now comprise only Lloyds TSB, RBS, HSBC, Barclays and Nationwide and all but Lloyds have recently reduced their interest rates significantly. Our external advisers, Sector, continue to recommend caution and currently suggest that no investment be placed for longer than 3 months with any bank other than Lloyds and RBS (a maximum of 1 year is suggested in their case). Lloyds TSB are currently offering rates of 1.35% for 3 months up to 2.70% for 1 year, which are both significantly better than the rates offered by other banks (around 0.55% currently offered by others for 3 months, while RBS are currently offering around 1.10% for 1 year). The “core” investments placed during the first six months of 2012/13 were all placed for between 3 months and a year (in accordance with Sector’s advice) or in instant access money market funds. The Finance Director will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.
- 3.8 The graph below shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years, largely due to increased and earlier government funding. This has been a significant contributor to the over-achievement of investment income against budget in recent years, although this has now been fully factored into the revenue budget.



Other accounts

3.9 Money Market Funds

The Council currently has 6 AAA-rated Money Market Fund accounts, with Fidelity, Prime Rate, Insight, Blackrock, Ignis and Legal & General. In common with market rates for fixed-term investments, interest rates on money market funds have fallen considerably in recent years. The Ignis fund currently offers the best rate (0.66%), which is around the level currently being offered for 5 months by some of our eligible UK banks and building societies. The total balance held in Money Market Funds (currently £72.4m) has increased significantly in recent months as bank credit ratings downgrades have restricted counterparty eligibility.

Money Market Fund	Date Account Opened	Ave. Rate 2012/13 (to 30/09/12) %	Ave. Daily Balance 2012/13 £m	Actual Balance 30/09/12 £m	Current Balance 03/10/12 £m	Current Rate 03/10/12 %
Prime Rate	15/06/09	0.72	7.5	15.0	15.0	0.61
Ignis	25/01/10	0.73	7.2	15.0	15.0	0.66
Insight	03/07/09	0.63	5.5	12.1	15.0	0.53
Legal & Gen.	23/08/12	0.53	1.4	15.0	15.0	0.56
Blackrock	16/09/09	0.48	2.6	-	12.4	0.41
Fidelity	20/11/02	0.43	0.2	-	-	0.37

3.10 Notice Accounts

In April 2012, the Council placed £15m in a 35-day notice account with Svenska Handelsbanken (Sweden). The total of £15m is still currently invested and, based on recent years, is likely to remain there until late-March 2013, when it will probably be redeemed to support year-end cashflow. It is earning interest at a rate of 0.85% and the average daily balance in the first six months of 2012/13 was £6.9m.

3.11 External Cash Management

External cash managers, Tradition UK Ltd, currently manage £20m of our cash portfolio and provide useful advice and information on treasury management matters. In the first half of 2012/13, Tradition UK achieved a return of 1.65% (mainly as a result of the two longer term investments placed in August 2011 and July 2012 (see table below). Tradition UK have also been constrained by strategy changes approved after the Icelandic Bank crisis and by recent ratings downgrades. Details of externally managed funds placed on deposit as at the time of writing this report are shown below.

Sum	Start Date	Maturity	Period	Rate
Tradition UK				
£12.5m	27/03/12	26/03/13	1 year	3 month Libor, subject to cap 1.10% & floor 0.50%
£2.5m	27/07/12	04/07/13	11 months	3.00%
£5m	17/08/11	16/08/13	2 years	2.80%

3.12 Investment with Heritable Bank

Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the

Icelandic bank, Landsbanki, when it was placed in administration in early-October 2008 at which time our investment was, and still is, frozen. The latest estimate given by the administrators, Ernst & Young, late in September 2011 indicates a likely return of between 86% and 90% of our claim, but Council officers and our external advisers remain hopeful of an even better result. An initial dividend was paid to the Council in July 2009 and, since then, a further 11 dividends have been received. To date, 74.6% (£3,793k) of our total claim (£5,087k) has been returned to us, leaving a balance of £1,294k (25.4%).

For information, the claim we were obliged to submit consisted of the principal sum (£5m) plus interest due to the date on which Heritable was placed in administration (around £87,000). We were not able to lodge a claim for the full amount of interest (£321,000) that would have been due at the original investment maturity date (29/6/09). In accordance with proper accounting practice and guidance from CIPFA, we made provision in our 2008/09 accounts for an impairment loss of £1.64m and met this from the General Fund in that year. In line with revised guidance from CIPFA relating to the 2009/10 accounts, we were able to reduce the impairment by £300k and this sum was credited to the General Fund. The improved recovery estimate of between 86% and 90% (previously it was between 79% and 85%) enabled us to reverse a further £730k of the impairment in 2011/12. This left a provision for a net loss of £610k in the accounts as at 31st March 2012, which will potentially reduce or clear depending on the size of the final settlement sum.

Mid-Year Review of Treasury Management Strategy Statement and Annual Investment Strategy for 2011/12

3.13 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required to receive a mid-year review report on performance against the approved strategy. The Annual Investment Strategy was approved by Council on 20th February 2012 and a mid-year review is included at Annex A.

Proposed changes to the Annual Investment Strategy

3.14 Credit ratings downgrades since the Icelandic banking crisis in 2008 have resulted in the removal of many of our established counterparties from our lending list and it has become increasingly difficult to identify institutions to place money with. As is outlined in paragraph 3.7, our current approved strategy only permits investments with Lloyds TSB, RBS, HSBC, Barclays and Nationwide and limits for these institutions are almost always fully utilised. As a result, new investments can only be placed as and when maturities occur.

3.15 The restrictions on our lending list have resulted in large sums being placed in low interest accounts (in instant access money market funds) and this has had a significant impact on the Council's interest earnings. Around £87m is currently invested in money market funds and 35-day notice money at an average rate of around 0.64% (£560k in a full year) and we could broadly expect to almost double this if we were able to place more for longer periods with eligible UK banks and building societies.

3.16 A proposal to the Executive on 19th October 2011 to increase the lending limit for the two part-nationalised banks (Lloyds TSB and RBS) from £40m to £60m was approved, "subject to this being implemented after 3 months dependent on the prevailing financial position". The position has been kept under review since that decision was made and no further action is proposed at this time.

3.17 In order to provide a degree of extra flexibility and potentially to earn additional interest at no added risk, it is proposed that the strategy be amended to permit investments in the following:

- corporate bonds and

- the Payden Sterling Reserve Fund.

3.18 Corporate Bonds

Until 1st April 2012, investments in corporate bonds were classified as capital expenditure, which meant that they had to either be financed by borrowing (which the Council does not undertake) or by using capital receipts that had accumulated over the years in order to finance essential works, improvements, etc of a capital nature. In April 2012, however, the CLG changed the rules on capital expenditure for English local authorities and this no longer counts as capital expenditure.

3.19 In essence, companies issue bonds in order to raise long-term capital or funding, rather than issuing equity. These are non-standardised compared to other investment vehicles, each having an individual legal document known as a “bond indenture”, which specifies the rights of the holder and the obligations that must be met by the issuer, as well as the characteristics of that particular bond. Investing in a corporate bond usually offers a fixed stream of income, known as a coupon, payable twice a year, for a fixed, predetermined period of time in exchange for an initial investment of capital.

3.20 Many investors prefer not to hold them until maturity, as they can often offer marginal capital growth, but trading before maturity can be very risky, especially during the current volatile times, and requires in depth fixed income knowledge and experience. For local authorities looking for a fixed income stream, however, the buy and hold strategy is far more appealing.

3.21 There are a number of benefits, drawbacks and risks to consider before and during investing in corporate bonds. The main benefits, drawbacks and risks are as follows:

Benefits / Counter measures

Potential for higher returns than gilts and other assets
 Potential for greater liquidity than fixed term deposits (if sold before maturity)
 Credit ratings, credit default swaps

Drawbacks / Risks

Higher perceived risk
 Risk of capital loss (if sold before maturity)
 Credit risk

NB. There are other risks, including interest rate risk, inflation risk, re-investment risk, default risk and call-in risk, most of which are the same for any type of investment. These will be controlled by risk management procedures built into the investment strategy and treasury management procedures and, as is always the case, potential investments will be discussed with external advisers.

3.22 If approved, custodian facilities will be required for the Council to purchase corporate bonds and the Council will use existing contacts with brokers and market makers to find bonds that are both suitable and available in the market.

3.23 It is proposed that the Council be asked to approve the addition of corporate bonds as eligible investment vehicles in our investment strategy with a minimum credit rating of AA-, a maximum investment period of 5 years and a maximum total exposure of £25m (this would be in line with the current approved limits for UK Government Gilts).

3.24 Payden Sterling Reserve Fund

This Fund has been in existence since July 2010 and seeks to outperform bank deposits and money market funds by investing in short-term investment-grade sterling denominated instruments. The Fund would offer the following benefits:

- It is primarily comprised of UK Government securities and government guaranteed securities and investment grade corporate bonds.

- The Fund is AAA rated and only invests in very high quality, short-dated bonds (60% of Fund invested in AAA rated bonds; minimum credit rating AA-).
- It offers broad diversification by investing in around 70 different bonds, thus substantially reducing credit and counterparty risk.
- Performance return 2.02% in the year ended 31st August 2012 (more than double the return from money market funds).
- It currently has around £170m in assets under management and this is expected to increase to over £200m in the near future.
- Around 20 local authorities invest in the Fund.
- Transparency is provided in the form of a full daily list of holdings and transactions.
- External adviser, Sector, support the inclusion of the Fund in local authority strategies.

3.25 It is proposed that the Payden Sterling Reserve Fund be included as an eligible counterparty in Bromley's strategy, with a maximum investment limit of £15m (the same limit applies to all our money market funds) and the PDS Committee and Portfolio Holder are asked to recommend this to full Council.

Regulatory Framework, Risk and Performance

3.26 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.27 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury

Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

- 4.1 In line with government guidance, the Council's policy is to seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

5. FINANCIAL IMPLICATIONS

- 5.1 An average rate of 1.5% was assumed for interest on new investments in the 2012/13 revenue budget (£2.69m), in line with estimates provided in January 2012 by the Council's external treasury advisers. The average rate obtained on all new investments placed since the budget was agreed is slightly above this at around 1.59%. The Bank of England base rate is still expected to rise, but the expected start of the rise has been put back to the end of 2014 and could be even later. The latest financial forecast assumes 1.5% in 2013/14, 2.00% in 2014/15, 3.0% in 2015/16 and 3.5% in 2016/17. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £400k pa from 2013/14. At this stage in the year, it is forecast that the 2012/13 outturn will broadly be on budget.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Sector

Treasury Management Strategy Statement and Annual Investment Strategy

Mid-year Review Report 2012/13

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 operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering maximising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives. In practice, the Council has not in the past borrowed to finance its capital expenditure and has no plans to do so at present.

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 2011 was adopted by this Council in February 2012.

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 & Resources PDS Committee:

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

- An economic update for the first six months of 2012/13;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- 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 review of compliance with Capital and Treasury Prudential Limits for 2012/13.

3 Economic update

3.1 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.

3.2 Outlook for the next six months 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.

3.3 Sector's interest rate forecast

	17.9.12 actual	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	0.50	0.75	1.00
3m LIBID	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.70	0.90	1.10	1.40
6m LIBID	0.85	0.85	0.85	0.85	0.85	0.85	1.00	1.10	1.30	1.50	1.80
12m LIBID	1.30	1.30	1.30	1.30	1.40	1.50	1.70	1.90	2.10	2.30	2.60

4 Treasury Management Strategy Statement and Annual Investment Strategy update

The Treasury Management Strategy Statement (TMSS) for 2012/13 was approved by this Council in February 2012. It is proposed that 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 in the covering report (see paragraphs 3.18 to 3.25).

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 which is consistent with the Council's risk appetite. As set out in Section 3 (Economic Update), 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.

Details of the Council's investment activity during the first six months of 2012/13 are provided in paragraphs 3.4 to 3.8 of the covering report and lists of current investments are provided in Appendices 1 (in maturity date order) and 2 (by counterparty). Excluding the frozen Heritable investment of £5m, the Council held £212.1m of investments as at 30th September 2012 (£173.9m as at 31st March 2012).

The Finance Director 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 £2.691m, and performance for the year to date is broadly in line with the budget.

7 Borrowing

The Council's capital financing requirement (CFR) as at 1st April 2012 was £3.6m. The CFR denotes the Council's underlying need to borrow for capital purposes and, for Bromley, relates to outstanding finance lease liabilities in respect of plant, equipment and vehicles. 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 does not borrow to finance its capital expenditure and has, in recent years, only had to borrow short-term (for cashflow purposes) on a very few occasions.

No borrowing is currently anticipated during this financial year or in any later financial year.

Prudential and Treasury Indicators – Mid Year Review 2012/13

The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2012/13 were approved by the Executive and the Council in February 2012 and this Annex sets out the actual performance against those indicators in the first half year, updating them where necessary. Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy.

The Council is required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the full Council in February 2002 and the revised 2011 Code was adopted by full Council in February 2012.

Prudential Indicators for Capital Expenditure

This table shows the revised estimates for capital expenditure and the changes since the Capital Programme for 2012/13 was agreed in February 2012. The increase in the latest estimate for 2012/13 is mainly the result of the significant level of slippage in expenditure planned for 2011/12, which has been highlighted in previous reports to the Executive and to PDS Committees.

Capital Expenditure by Portfolio	2012/13 Original Estimate £m	2012/13 Revised Estimate £m
Education	15.8	22.1
Renewal & Recreation	4.3	7.5
Environment	6.3	6.4
Care Services	6.5	6.9
Resources	1.4	4.2
Add: allowance for new schemes	2.5	-
Less: estimated slippage	-5.0	-10.0
Total	31.8	37.1

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	2012/13 Original Estimate £m	2012/13 Revised Estimate £m
Supported	31.8	37.1
Unsupported	0.0	0.0
Total spend	31.8	37.1
Financed by:		
Capital receipts	6.1	7.0
Capital grants	12.8	17.1
Other external contributions	11.8	10.4
Revenue contributions	1.1	2.6
Total financing	31.8	37.1
Borrowing need	0.0	0.0

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) as at 1st April 2012 was £3.6m. 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 relates to liabilities arising from finance leases entered into in recent years in respect of various items of plant and equipment. The Council currently has no external borrowing as such. We are on target to achieve the original forecast Capital Financing Requirement for 2012/13.

Prudential Indicators	2012/13 Original Estimate £m	2012/13 Revised Estimate £m
CFR	6.9	3.3
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

Other Prudential Indicators

Other indicators designed to control overall borrowing and exposures to interest rate movements are included in the summary table below, which will require the approval of full Council.

ANNEX B1 Prudential and Treasury Indicators - Summary

	2012/13	2012/13
	Original Estimate	Revised Estimate
	£m	£m
Total Capital Expenditure	£31.8m	£31.7m
Ratio of financing costs to net revenue stream	-1.5%	-1.5%
Net borrowing requirement (net investments for Bromley)		
brought forward 1 April	£143.0m	£170.3m
carried forward 31 March	£143.1m	£176.7m
in year borrowing requirement (reduction in net investments for Bromley)	£0.1m	£6.4m
Estimated CFR as at 31 March (finance lease liability) (NB. Actual CFR as at 31 March 2012 (finance lease liability) = £3.6m)	£6.9m	£3.3m
Annual change in Cap. Financing Requirement	-£0.3m	-£0.3m
Incremental impact of capital investment decisions	£ p	£ p
Increase in council tax (band D) per annum	-	-

TREASURY MANAGEMENT INDICATORS	2012/13 Original Estimate £m	2012/13 Revised Estimate £m
Authorised Limit for external debt -		
borrowing	£30.0	£30.0
other long term liabilities	£30.0	£30.0
TOTAL	£60.0	£60.0
Operational Boundary for external debt -		
borrowing	£10.0	£10.0
other long term liabilities	£20.0	£20.0
TOTAL	£30.0	£30.0
Upper limit for fixed interest rate exposure	100%	100%
Upper limit for variable rate exposure	20%	20%
Upper limit for total principal sums invested beyond year-end dates	£80.0	£80.0