AUDIT COMMITTEE	Agenda Item 45 Brighton & Hove City Council

Subject:		***Treasury Management Policy Statement 2009/10 (including Annual Investment Strategy 2009/10) – Mid Year Review***		
Date of Meeting:		**12 November 2009 – Cabinet** **15 December 2009 – Audit Committee for noting**		
Report of:		***Director of Finance & Resources***		
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Key Decision:	No			
Wards Affected:	All			

FOR GENERAL RELEASE

1. SUMMARY AND POLICY CONTEXT:

1.1 The Treasury Management Policy Statement 2009/10 (TMPS) and the Treasury Management Practices (including the schedules) (TMPs) for the year commencing 1 April 2009 were approved by Cabinet on 12 March 2009. Full Council approved the Annual Investment Strategy 2009/10 (AIS), which forms part of the TMPS, on 19 March 2009. The policy statement sets out the key role for treasury management, whilst the practices and schedules set out the annual targets for treasury management and the methods by which these targets shall be met. The AIS sets out the parameters within which investments can be made.

1.2 The purpose of this report is to advise of the action taken during the period April to September 2009 to meet the policy statement and practices and the investment strategy.

2. RECOMMENDATIONS:

Recommendations for Cabinet:

2.1 That Cabinet endorses the action taken during the half-year to meet the Treasury Management Policy Statement 2009/10 and associated Treasury Management Practices and the Annual Investment Strategy 2009/10.

2.2 That Cabinet endorses the proposed change to the benchmarking for investments as set out in paragraph 3.4 and set the maximum indicator for risk at 0.05%.

2.3 That Cabinet notes the authorised limit and operational boundary set by the Council have not been exceeded.

Recommendation for Audit Committee

2.4 That the Audit Committee notes the report.

3. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:

Overview of markets

3.1 During the half-year the financial markets entered calmer waters and the worst fears of global depression and bank meltdown subsided. Nevertheless, while economies showed tentative signs of stabilising, a return to a positive growth path was still considered to be a long way off.

3.2 The bias of policy decisions by the Bank of England continued towards stimulating the economy by releasing money into the financial markets. Official rates remained at ½% but quantitative easing was increased to £175 billion. Lending between banks has improved but the availability of credit to a wider cross section of the economy remained a problem.

3.3 The UK economy continued to post a mixed performance. The low point of the business cycle is believed to have been passed but many analysts remain sceptical about the speed of return to trend growth and the sustainability of any recovery.

3.4 A commentary on the markets is set out in Appendix 1 to this report.

Treasury Management Strategy

3.5 A summary of the action taken in the six months to September 2009 is provided in Appendix 3 to this report. The main points are:

- long-term debt portfolio (which has been used to fund the capital investment programme) has reduced from £195.9m to £165.7m. This reflects the decision to continue the programme to reduce the risk on the investment portfolio by repaying debt early;

- short-term debt has been raised to part fund cash flow shortfalls. The balance outstanding as at 30 September totals £6.1m;

- the level of investments as at 30 September 2009 totalled £40.6m, a reduction of £15.9m from the beginning of the year (due to the debt repayment programme);

- the return on investments by the in-house treasury team and cash manager has significantly exceeded the target rate;

- the two borrowing limits approved by Budget Council in February 2009 – the ‘authorised limit’ and ‘operational boundary’ – have not been exceeded in the first half of the year.

3.6 The decision to reduce capital risk on the investment portfolio by repaying debt has had a significant impact on treasury management activity. This impact is demonstrated in the table below which compares treasury activity in the half-year to September 2009 with the corresponding period in the previous two years. Short-term borrowing is now used to meet day-to-day cash flow shortages, whereas in the previous two years investments were used.

	April / Sept 2007	April / Sept 2008	April / Sept 2009
Short-term borrowing raised	£2.5m	£0.0m	£42.5m
Short-term borrowing repaid	£2.5m	£0.0m	£36.4m
Investments made	£351.9m	£343.7m	£233.5m
Investments maturing	£270.6m	£248.9m	£249.5m

3.7 Application of the cash flow surplus has also changed. In the first six months in 2007 and 2008 the surplus was primarily invested, whereas in the current year the surplus has been used to repay long-term debt.

	April / Sept 2007	April / Sept 2008	April / Sept 2009
Cash flow surplus	£31.9m	£28.6m	£7.6m
Increase / (decrease) in long-term borrowing	(£2.0m)	£0.0m	(£30.2m)
Increase / (decrease) in short-term borrowing	£0.0m	£0.0m	£6.1m
Decrease / (increase) in investments	(£29.9m)	(£28.6m)	£16.5m

3.8 Capital risk on the investment portfolio has always been the primary objective for the council's investment strategy. The decision to repay borrowing by reducing investments was a consequence of downward revisions to the credit ratings of the majority of institutions within which the council invested. At the meeting in November 2008 Cabinet was informed that the investment period for all new investments has been reduced to a maximum of one month and that selection of investment counterparty would be more intensive. A number of institutions remain suspended from the council's counterparty list due to downgrades in their rating. The financial implications of this strategy are set out in section 5.

Capital risk v Interest rate risk

3.9 The reduction in investments has maintained the council's strategy on capital risk. This strategy will continue until such time as the markets recover sufficiently for the rating agencies to assign approved ratings.

3.10 The projected borrowing level for the council is estimated at around £260m, whereas actual long-term borrowing outstanding is £166m. This means that the council is temporarily using internal reserves to fund capital investment and this can not continue indefinitely as over time the reserves are planned to be spent.

3.11 The next major decision is therefore when to undertake new long term borrowing. If this decision is undertaken too early the difference between the borrowing rate (4% plus) and the investment rate (currently up to 1%) will place severe pressures on the revenue budget in the short-term. If this is done too late when long-term borrowing rates have risen as anticipated then the cost of borrowing will rise placing pressures on the revenue budget over the long-term. The average cost of borrowing repaid under the current strategy is between 4¼% and 4½% and this therefore represents the target rate for new borrowing in the future.

3.12 The timing of the decision is therefore critical and officers will therefore keep the position under constant review to ensure that interest rate risk is minimised whilst at the same time ensuring the strategy on capital risk is not jeopardised. One of the options being investigated is to enter into borrowing deals that fix the rate of future borrowing up to 18 months in advance of the actual borrowing.

Performance measures

3.13 In response to the recent inquiries into local authority investments (following the collapse of Icelandic banks) the Chartered Institute of Public Finance & Accountancy is reviewing the code of practice on treasury management. Details of the changes will be reported to Cabinet as part of the 2010/11 treasury management and investment strategies. The council has already responded to one of the changes by arranging a training session for all Members involved in treasury management decision making on 19 January 2010.

3.14 Another of the changes proposed is greater Member involvement in the consideration and benchmarking of the investment portfolio. The council's treasury advisors have developed a matrix that measures investment risk in terms of both security and liquidity. Appendix 2 sets out the basis of this matrix.

3.15 The recommendation in this report is to apply a risk indicator from November 2009 and to set a maximum limit on risk of 0.05%.

4. CONSULTATION

4.1 The council's external treasury advisors have been consulted in the drafting of this report. No other consultation was necessary.

5. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

5.1 The financial implications arising from the action taken under the TMPS are included in Financing Costs. The month 6 forecast for financing costs shows that £400,000 less of the reserve set up to offset the projected short-term reductions in investment income will be needed during 2009/10. The reserve is projected to stand at £2.481m at the end of 2009/10.

5.2 The repayment of debt has resulted in a net saving to the council of around £1.2m after taking account of the loss of investment income. The HRA proportion of this saving is £625k. However due to the perverse nature of the calculations within the HRA subsidy system, together with the sharp fall in official short-term interest rates, the HRA will lose subsidy of approx £920k, a net reduction in HRA resources of £295k in 2009/10.

5.3 The net reduction in HRA resources is likely to be short-term but the implications on the HRA in future years will depend upon 3 key factors – the speed of recovery in the UK financial markets, the timing and level of new borrowing and the timing and impact of the proposed changes to the housing finance system. As new borrowing is made and short-term interest rates increase the net reduction in HRA resources will reverse.

Finance Officer Consulted: Peter Sargent Date: 19/10/09

Legal Implications:

5.4 Action under the TMPS must be in accordance with Part I of the Local Government Act 2003 and regulations issued thereunder. Relevant guidance also needs to be taken into account.

5.5 This report is for information purposes only and as such it is not considered that anyone's rights under the Human Rights Act will be adversely affected by it.

Lawyer Consulted: Abraham Ghebre-Ghiorghis Date: 27/10/09

Equalities Implications:

5.6 There are no direct implications arising from this report.

Sustainability Implications:

5.7 There are no direct implications arising from this report.

Crime & Disorder Implications:

5.8 There are no direct implications arising from this report.

Risk & Opportunity Management Implications:

5.9 The continuing uncertainty in the financial markets means the increased risk in lending has not abated. The action taken in the first six months of 2009/10 has resulted in the council reducing capital risk on its investment portfolio but has, in effect, replaced this with interest rate risk.

5.10 The position will be regularly monitored and, when confidence returns to the financial markets, opportunities to raise new borrowing and rebuild the investment portfolio will be considered.

Corporate / Citywide Implications:

5.11 Investment income is used to support the budget requirement for the council. Any action taken to reduce the risk of capital loss will have a downward impact on the level of interest received.

6. EVALUATION OF ANY ALTERNATIVE OPTION(S):

6.1 This report sets out action taken in the six months to September 2009. No alternative options are therefore considered necessary.

7. REASONS FOR REPORT RECOMMENDATIONS

7.1 The TMPS requires the Director of Finance & Resources to report on the action taken by the council in meeting borrowing limits and investment parameters after the first 6 months and at the end of the financial year. This report fulfils the first reporting requirement.

SUPPORTING DOCUMENTATION

Appendices:

1. Market Overview – April to September 2009
2. Security, Liquidity and Yield Benchmarking (Benchmarking and monitoring security, liquidity and yield in the investment portfolio)
3. A summary of the action taken in the period April to September 2009
4. Performance and balances

Documents in Members' Rooms

None

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations
2. The Treasury Management Policy Statement and associated schedules 2009/10 approved by Cabinet on 12 March 2009
3. The Annual Investment Strategy 2009/10 approved by full Council on 19 March 2009
4. Papers held within Strategic Finance, Finance & Resources
5. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2003