Leeds
CITY COUNCIL

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Report of the DIRECTOR OF RESOURCES

Executive Board

Date: 3rd November 2010

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2010/11

Electoral Wards Affected:	**Specific Implications For:**	
	Equality and Diversity	☐
	Community Cohesion	☐
	Narrowing the Gap	☐

Eligible for Call In	√	Not Eligible for Call In (Details contained in the report)	☐

EXECUTIVE SUMMARY

1. This report provides a review and update of the treasury management strategy for 2010/11.

2. The Council's level of external debt as at 31st March 2011 is anticipated to be £1,620m, £40m higher than that was approved in February 2010. This is due to an increase in borrowing required to fund the capital programme which includes equal pay costs.

3. Monitoring of money and financial markets has enabled revenue savings of £4.7m to be made against £7.9m assumed in the budget. This is largely due to previous actions of repaying long term debt and maintaining funding through short-term loans at historic low rates.

4. The investment of surplus monies will continue to have due regard for security of capital in accordance with the Council's approved investment strategy.

5. The level of debt is expected to remain within the Authorised limits for external debt as agreed by Council on 24th February 2010.

6. Following the CSR the cost of borrowing for new loans has increased by an average of 0.85% bringing the margin paid above gilts to 1%. This will increase the cost of borrowing by £85k for each additional £10m borrowed.

1.0 Purpose Of This Report

1.1 The 2010/11 treasury management strategy was approved by Executive Board on 12th February 2010. This report provides a review and update of the strategy for 2010/11.

2.0 Background Information

2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities (amended 2009) in particular:

- The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of Prudential indicators.
- Any in year revision of these limits must be set by Council.
- Policy statements are prepared for approval by the Council at least twice a year.

3.0 Main Issues

3.1 ***Review of Strategy 2010/11***

3.1.1 The current borrowing forecasts are shown in Table 1.

Table 1

ANALYSIS OF BORROWING 2010/11		2010/11 This Report £m	2011/12 £m	2012/13 £m
Net Borrowing at 1 April		**1,414**	1,620	1,689
New Borrowing for the Capital Programme – Non HRA		**188**	99	48
New Borrowing for the Capital Programme – HRA		**15**	3	3
Debt redemption costs charged to Revenue (Incl HRA)		**(27)**	(33)	(36)
Reduced/(Increased) level of Revenue Balances		**30**	0	0
Net Borrowing at 31 March*		**1,620**	1,689	1,704
Capital Financing Requirement		**1,765**	1,833	1,847
* Comprised as follows				
Long term borrowing	Fixed	**1,329**	1,516	1,560
	Variable (less than 1 Year)	**25**	55	50
	New Borrowing	**272**	69	15
Short term Borrowing		**25**	70	90
Total External Borrowing		**1,651**	1,710	1,715
Less Investments		**31**	21	11
Net External Borrowing		**1,620**	1,689	1,704
% borrowing funded by short term and variable rate loans		**20%**	11%	9%

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes.

3.1.2 Table 1 above shows that 2010/11 net external borrowing is now forecast at £1,620m, £40m higher that in the report to Executive Board on 12th February 2010. The Increase is due to the need to borrow more to fund the capital programme (including equal pay).

3.1.3 In the early part of the year the world economies were driven by the sovereign debt crises, following concerns about the Greek government's total debt and annual deficit. The real worry in Europe was that any default on debt repayments would have had a substantial impact on other countries in particular, Portugal, Spain and Ireland. This crisis culminated in the EU and IMF putting together a €750bn support package in mid May.

3.1.4 Whilst growth in the US, UK and the Euro zone in quarter 2 of 2010 was encouraging it is unlikely to be repeated in second half of the year. Market expectations are that the growth rebound has peaked and indications are pointing downwards, though not necessarily into negative territory.

3.1.5 As with other economies, the UK is in the process of rolling out austerity plans to correct the public sector deficit over the next five years. The inevitable result of fiscal contraction will be major job losses during this period, in particular in public sector services. This will have a knock on effect on consumer and business confidence. House prices have started a negative trend during the summer and mortgage approvals are sluggish and declining.

3.1.6 Key indicators suggest that:

- GDP growth is likely to have peaked at 1.2% in quarter 2 of 2010.
- The trend of falling unemployment (on the benefit claimant count) has now been replaced since July with small increases which are likely to be the start of a new trend of rising unemployment.
- CPI has remained high so far during 2010. It peaked at 3.7% in April and has fallen back to 3.1% in August. RPI remains high, at 4.7% in August. Although inflation has remained stubbornly above the MPC's 2% target, the MPC is confident that inflation will fall back under the target over the next two years. The last quarterly Inflation Report in August showed inflation significantly below 2% after the end of 2011.

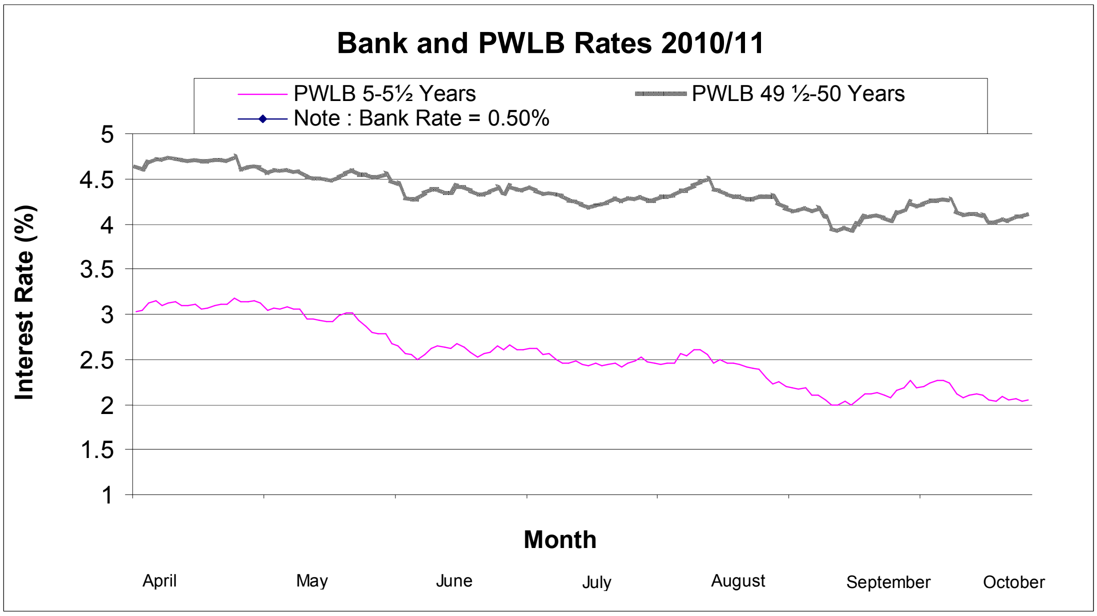
3.1.7 The Bank of England originally finished its £200bn programme of quantitative easing in November 2009. Following the Bank of Japan's decision to increase quantitative easing, it is possible that other countries including the UK will follow.

3.1.8 The UK economy could take a number paths ranging from strong recovery to a further slip back into recession. The key factors that will shape its direction are likely to be:

- the speed of economic recovery in the US and EU
- the degree to which government austerity programmes will dampen economic growth
- the speed of rebalancing of the UK economy towards exporting and substituting imports
- changes in the consumer savings ratio
- the potential for more quantitative easing, and the timing of this in both the UK and US
- the speed of recovery of banks' profitability and balance sheet imbalances
- the potential for a major EU sovereign debt crisis which could have a significant impact on financial markets and the global and UK economy

3.1.9 The overall balance of risks is weighted to the downside and there is some risk of a double dip recession and continued deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices, although this is currently viewed as being a small risk.

3.1.10 The following table shows how gilts have performed since the start of the financial year.



3.1.11 The general trend has been a reduction in interest rates during the first six months of the year, across all bands, with the low points occurring in the middle to end of August. The Council's Treasury advisors forecast that the Bank rate is unlikely to increase from its historic low of 0.5% until the middle of 2011. The outlook is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

3.1.12 Whilst the current strategy of funding the borrowing requirement to support the capital programme is from short dated loans, there will come a point when rates begin to rise and more expensive longer dated funding will be required. The Director of Resources will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time.

3.1.13 No rescheduling of long term debt has taken place in 2010/11. The replacement of long dated loans from previous rescheduling exercises, already reported to Executive Board, are detailed in table 2 below:

Table 2

Rescheduling 2010/11							
Premature Repayments				New Replacement Borrowing			
Date	Amount (£m)	Original Rate (%)	Discount Rate	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB				PWLB			
				26/05/2010	20	50	4.28
Sub Total	**0**				**20**		
LOBOs (Call date)				Market Loans			
				22/04/2010	2	1	0.65
				14/05/2010	1	1	0.55
Sub Total	**0**				**3**		
Total	**0**				**23**		

3.1.14 The strategy outlined in the February Treasury Executive Board Report has been maintained. Short term debt at low rates of interest and existing revenue balances continue to be used to fund this years borrowing requirement, and the remaining balance of previous years rescheduling. This has enabled savings of £4.7m against a budgeted target of £7.9m for the year to be made.

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3.2 ***Borrowing Limits for 2010/11, 2011/12 and 2012/13***

3.2.1 The Council is required to set various limits for 2010/11, 2011/12 and 2012/13 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code (as amended 2009). These limits including prudential indicators are detailed in Appendix A.

3.2.2 New borrowing limits for 2010/11 were approved by Council on 12th February 2010 and are set out below in Table 4.

Table 3

	2010/11 February 2010 £m	**2010/11 This Report £m**
Authorised Limits		
Borrowing	1,830	1,830
Other Long Term Liabilities	380	380
Total	**2,210**	**2,210**
Operational Boundary		
Borrowing	1,690	1,690
Other Long Term Liabilities	370	370
Total	**2,060**	**2,060**

3.2.3 It is anticipated that the authority will continue to remain within the authorised limits for 2010/11. Both the authorised limit and operational boundary are made up of a limit for borrowing and one for other long term liabilities and the Director of Resources has authority, under the Prudential Code, to vary these two elements within the overall limits. Current performance against borrowing limits is shown in Appendix B.

3.3 ***Investment Strategy & Limits***

3.3.1 The Council's external debt is reduced by the availability of revenue balances. The Treasury policy also allows for the external investment of these balances at advantageous rates but with due regard for security of capital invested. The Council's surplus monies continue to be held in short periods until required. As market sentiment to counter-party risk improves, together with enhanced returns surplus monies will be invested in accordance with the approved lending list. This lending list is based upon the assessment of the financial standing of counterparties as determined by international credit rating agencies and further refined and updated by the Council's advisors on a continual basis. The lending list is often further restricted based upon the Council's own view of the credit worthiness of counter-parties.

3.3.2 The investment strategy, as re-affirmed by Executive Board and full Council in February, allows for the Council to invest in only the most highly rated financial institutions around the world. The Council will only lend to a maximum of £15m to financial institutions that are rated as excellent. There is also a limit of £5m for financial institutions that are rated as very good.

3.4 ***Comprehensive Spending Review (CSR)***

3.4.1 The CSR on 20/10/10 resulted in the cost of any future borrowing from the PWLB increasing by an average of 0.85% to 1% above the price of gilts. This increase does not affect the interest paid on existing fixed debt but will affect any new long term borrowing. Members are asked to note that new borrowing does not just include borrowing for new capital schemes, but also includes that which has been funded at low short term rates or by balances that the Council has. The average cost of borrowing £10m will now increase by around £85k to £950k.

3.4.2 Members will recall in the February annual strategy report 2010/11 that the average cost of borrowing for the authority was at a low, but was forecast to increase in future years. This latest change will only add to those forecasts. The increase in debts costs will need to be reflected in future capital spending decisions that are made.

4.0 Implications For Council Policy and Governance

4.1 The framework within which Treasury Management function is governed is set out in section 2. Within the Council, Executive Board consider updates on the treasury strategy twice a year: in the half year report and when setting the following year's strategy. Any changes to borrowing limits require the approval of full Council.

5.0 Legal and Resource Implications

5.1 This update on the treasury strategy recognises the borrowing necessary to fund the capital programme requirements of both General Fund and HRA. Where borrowing is supported the revenue costs are met by the Government, whilst for unsupported borrowing revenue costs are met either by the General Fund or HRA.

5.2 Following the CSR the cost of borrowing for new loans has increased by 0.85% to 1% above gilts. This will increase the cost of borrowing by £85k for an additional £10m borrowed.

6.0 Conclusions

6.1 The Council's level of external debt at 31st March 2011 is anticipated to be £1,620m, £40m above expectations in February 2010. This increase is due to additional borrowing to fund the capital programme (including equal pay).

6.2 Treasury Management activity has enabled revenue savings of £4.7m to be made against £7.9m assumed in the budget. This is largely due to funding the Council's borrowing requirement from short-term loans at historic low rates.

6.3 It is anticipated that the authority will remain within the approved limits for 2010/11 as outlined in Table 3 and paragraph 3.2.3.

7.0 Recommendations

That the Executive Board:

7.1 Note the update on Treasury Management borrowing and investment strategy for 2010/11.

<u>Associated documents:</u>

a) Treasury Management Strategy 2010/11 - Executive Board 12th February 2010.

Appendix A

Leeds City Council - Prudential Indicators 2010/11 - 2012/13

No.	PRUDENTIAL INDICATOR	2010/11	2011/12	2012/13
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note1)	10.73%	13.56%	14.01%
2	HRA	13.35%	15.32%	15.16%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	121.36	162.77	178.65
4	increase in housing rent per week	0.00	1.00	1.00
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
	Estimate of total capital expenditure			
6	Non HRA	351,306	190,038	88,080
7	HRA	73,751	10,962	40,916
	TOTAL	425,057	201,000	128,996
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	956,763	1,022,164	1,033,764
9	HRA	808,642	811,201	813,714
	TOTAL	1,765,405	1,833,365	1,847,478

No.	PRUDENTIAL INDICATOR	2010/11	2011/12	2012/13
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 5)**			
	borrowing	1,830,000	1,900,000	1,900,000
	other long term liabilities	380,000	380,000	380,000
	TOTAL	2,210,000	2,280,000	2,280,000
11	**Operational boundary - (Note 5)**			
	borrowing	1,690,000	1,760,000	1,760,000
	other long term liabilities	370,000	370,000	370,000
	TOTAL	2,060,000	2,130,000	2,130,000
14	**Upper limit for fixed interest rate exposure**			
	expressed as either:-			
	Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
	Net interest re fixed rate borrowing / investments			
15	**Upper limit for variable rate exposure**			
	expressed as either:-			
	Net principal re variable rate borrowing / investments OR:-	40%	40%	40%
	Net interest re variable rate borrowing / investments			
17	**Upper limit for total principal sums invested for over 364 days (Note 5**	150,000	150,000	150,000
	(per maturity date)			

16	Maturity structure of fixed rate borrowing 2010/11	Lower Limit	Cumulative Upper Limit	Projected 31/03/11
	under 12 months	0%	10%	4.3%
	12 months and within 24 months	0%	10%	6.3%
	24 months and within 5 years	0%	30%	23.6%
	5 years and within 10 years	0%	25%	6.3%
	10 years and above	25%	90%	59.6%

Notes.

1 **The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.**

2 **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property. No assumption of treasury management savings have been made from 2011/12 onwards and will be reviewed at a later stage.**

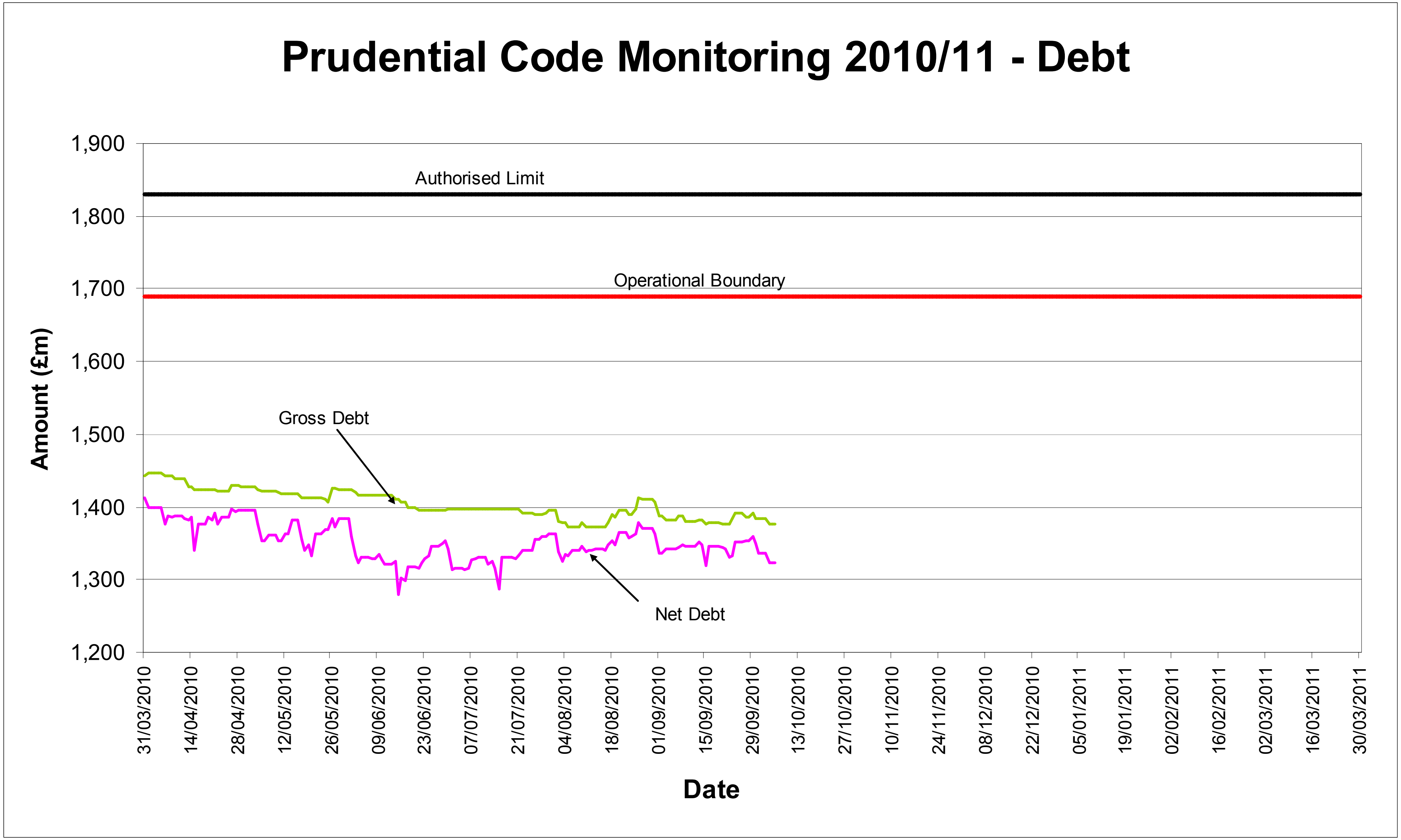
3 **In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.**

4 **Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.**

5 **Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003, and the revised code in Frebruary 2010**

6 **The HRA figures are based upon the continuation of the current Housing Subsidy Regime . However, it should b noted that the current review of Council Housing Finance may result in this being replaced by a system of self financing for local housing authorities.**

Appendix B


Prudential Code Monitoring 2010/11 - Debt
Authorised Limit
Operational Boundary
Gross Debt
Net Debt
Amount (£m)
1,900
1,800
1,700
1,600
1,500
1,400
1,300
1,200
31/03/2010
14/04/2010
28/04/2010
12/05/2010
26/05/2010
09/06/2010
23/06/2010
07/07/2010
21/07/2010
04/08/2010
18/08/2010
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