Leeds
CITY COUNCIL

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Report of Director of Resources

Report to Executive Board

Date: 2nd November 2011

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2011/12

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	☐ Yes	☑ No
Are there implications for equality and diversity and cohesion and integration?	☐ Yes	☑ No
Is the decision eligible for Call-In?	☑ Yes	☐ No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	☐ Yes	☑ No

Summary of main issues

1. This report provides a review and update of the treasury management strategy for 2011/12.

2. The Council's level of external debt as at 31st March 2011 is anticipated to be £1,609m, £14m lower than approved in February 2011.

3. Monitoring of money and financial markets has enabled forecast revenue savings of £6.5m against a budgeted target of £3.9m for the year. This is largely due to continuing to fund the borrowing requirement from short-term loans at historic low rates and internal cash balances.

4. The level of debt is expected to remain within the Authorised limit for external debt as agreed by Council on 11th February 2011.

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

6. Proposed changes to the Housing Subsidy system are expected to achieve royal assent by the end of the year in time for implementation by 1st April 2012. The changes will mean the separation of loans between general fund and the housing revenue account. The Council will have a share of its PWLB loans redeemed by the Government but will no longer receive housing subsidy support for these loans.

Recommendations

7. That the Executive Board note the update on Treasury Management borrowing and investment strategy for 2011/12.

1 Purpose of this report

1.1 The 2011/12 treasury management strategy was approved by Executive Board on 11th February 2011. This report provides a review and update of the strategy for 2011/12.

2 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 three times a year.

3 Main issues

3.1 Review of Strategy 2011/12

3.1.1 The current borrowing forecasts are shown in Table 1

Table 1

ANALYSIS OF BORROWING 2011/12		2011/12 This Report £m	2012/13 £m	2013/14 £m
Net Borrowing at 1 April		**1,457**	1,609	1,644
New Borrowing for the Capital Programme – Non HRA		**129**	81	9
New Borrowing for the Capital Programme – HRA		**3**	0	0
Debt redemption costs charged to Revenue (Incl HRA)		**(32)**	(36)	(38)
Reduced/(Increased) level of Revenue Balances		**52**	(10)	(12)
Net Borrowing at 31 March*		**1,609**	1,644	1,603
Capital Financing Requirement		**1,802**	1,846	1,816
* Comprised as follows				
Long term borrowing	Fixed	**1,319**	1,485	1,415
	Variable (less than 1 Year)	**40**	50	130
	New Borrowing	**216**	35	(41)
Short term Borrowing		**65**	85	105
Total External Borrowing		**1,640**	1,655	1,609
Less Investments		**31**	11	6
Net External Borrowing		**1,609**	1,644	1,603
% borrowing funded by short term and variable rate loans		**20%**	10%	12%

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing PFI 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. The above reflects only the borrowing element of the CFR

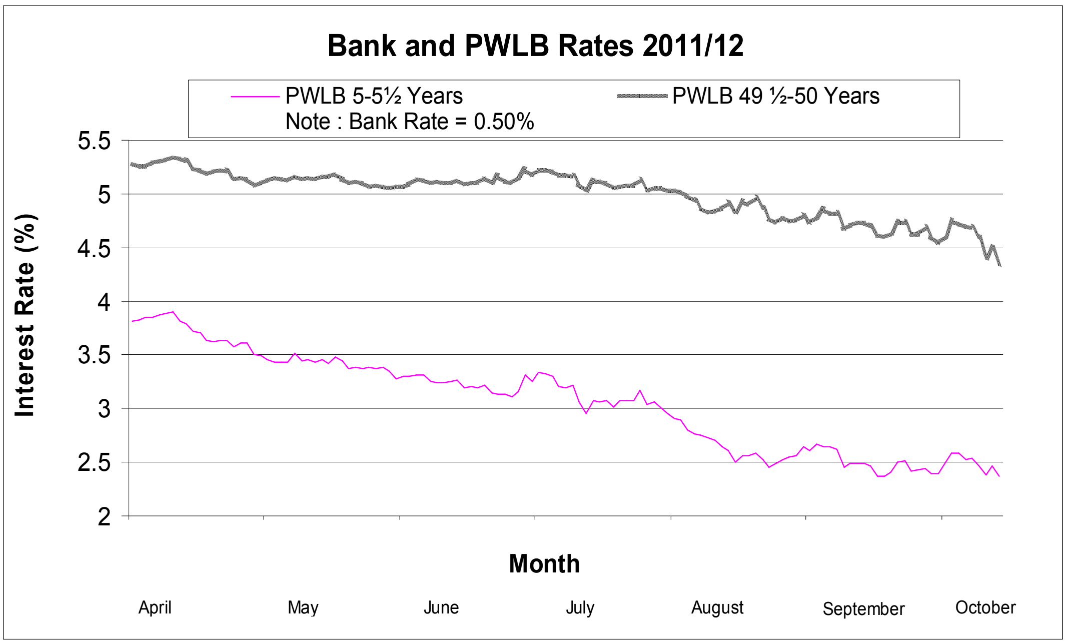
3.1.2 Table 1 above shows that 2011/12 net external borrowing is now forecast at £1,609m, £14m lower than in the report to Executive Board on 11th February 2011.

3.1.3 The Euro zone sovereign debt crisis has continued to weigh negatively on market sentiment. Greece, Ireland and Portugal have received support and the markets are focusing their attention on Italy and Spain. A €440bn bailout fund, agreed in September, has brought temporary relief but it does not solve the Greek debt problem or further potential calls for support from other countries. The risk of a sovereign default remains strong.

3.1.4 Growth in the US, UK and the euro zone has been lower than expected, with future prospects similarly cut. Concerns of a double dip recession in some Western countries have increased and world stock markets fell in the second quarter of 2011/12 as a consequence. 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. The Bank of England now consider that such low growth is a bigger concern than the threat of higher inflation therefore announced on 6th October a further £75bn of quantitative easing. The overall balance of risks is weighted to growth being lower than forecast with the risks to growth forecasts:

- 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.

3.1.5 The following table shows how the cost of longer term borrowing from the Government through PWLB loans have performed since the start of the financial year.



3.1.6 Despite weak UK growth 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 and additional quantitative easing has helped to add downward pressure on gilt yields and sent PWLB borrowing rates to lower levels. The longer term forecast is still for PWLB borrowing rates 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.

3.1.7 Low growth in the UK is set to continue and supports the view that the Bank Rate will continue at 0.5% for at least 24 months, coupled with a possible further extension of quantitative easing. The Bank Rate has now been at 0.5% for 30 months.

3.1.8 The current borrowing strategy continues to fund the borrowing requirement of the capital programme from short dated loans and internal cash balances. There will come a point when rates begin to rise and more expensive longer dated funding will be required, even though this has been pushed further back than originally envisaged. The Director of Resources will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time. This includes the assessment of other sources of raising finance. Table 2 shows new loans that were acquired to fund maturities and also highlights that no rescheduling of long term debt has taken place in 2011/12. No long term borrowing to fund the capital programme has taken place for 2011/12 or the two previous years.

Table 2

Rescheduling and Funding 2011/12							
Premature Repayments				New Replacement Borrowing			
Date	Amount (£m)	Original Rate (%)	Discount Rate	Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB				PWLB			
				07/09/2011	10	4.5	2.18
				07/09/2011	10	9	3.3
				07/09/2011	10	11.5	3.74
Sub Total	**0**				**30**		
LOBOs (Call date)				Market Loans			
				01/04/2011	10	1.5	1.57
				15/07/2011	10	2	1.45
				01/09/2011	2.5	35	3.99
				01/09/2011	7.5	35	3.99
Sub Total	**0**				**30**		
Total	**0**				**60**		

3.1.9 As mentioned above the use of short term debt at low rates of interest and existing revenue balances continue to fund the borrowing and has resulted in forecast savings of £6.5m (including £1m of MRP) to be made against a budgeted target of £3.9m for the year.

3.2 Borrowing Limits for 2011/12, 2012/13 and 2013/14

3.2.1 The Council is required to set various limits for 2011/12, 2012/13 and 2013/14 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 2011/12 were approved by Council on 12th February 2011 and are set out below in Table 3.

Table 3

	2011/12 February 2011 £m	2011/12 This Report £m
Authorised Limits		
Borrowing	1,900	1,900
Other Long Term Liabilities	600	600
Total	**2,500**	**2,500**
Operational Boundary		
Borrowing	1,760	1,760
Other Long Term Liabilities	565	565
Total	**2,325**	**2,325**

3.2.3 It is anticipated that the authority will continue to remain within the authorised limits for 2011/12. 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. At present 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 up 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. The current investment counter party list restricts new investments to a maximum of 3 months unless they are UK based and supported by the Government.

3.4 Housing Subsidy – Housing Revenue Account (HRA) Changes

3.4.1 The changes to the Housing Subsidy system are expected to achieve royal assent by the end of the year in time for implementation by 1st April 2012. The changes will mean that the Council will have a proportion of its PWLB loans paid off by the Government but will equally no longer receive housing subsidy support for these loans that are redeemed. Work is underway to establish a system that allocates loans and interest costs between the general fund and HRA, as the current statutory method of apportioning debt charges between the general fund and HRA will cease. The overriding principles of the new system must ensure that:

- any apportionment of debt will not be to the detriment of the General Fund.
- the split of loans is broadly equitable between the Housing Revenue Account (HRA) and General Fund.
- Future charges to the HRA in relation to borrowing are not influenced by General Fund decisions, giving a greater degree of independence, certainty and control.
- Un-invested balance sheet resources which allow borrowing to be below the CFR are identified between General Fund and HRA.

3.4.2 The Treasury announced on 19th September 2011, that the PWLB will offer loans at a 80-90 basis point discount to those authorities that will need to take on HRA debt under the revised system. This discount will not be available to Leeds as it will have a share of its loans redeemed under the new arrangements. The Annual Treasury Management Report 2012/13, to be presented to Executive Board in February, will provide a further update on the implications of the proposed changes to the management of HRA debt.

4 Corporate Considerations

4.1 Consultation and Engagement

4.1.1 This report is an update on strategy as present to Executive Board in February, as such no consultation has taken place. However, consultation with the Council's treasury advisors takes place regularly through the year.

4.2 Equality and Diversity / Cohesion and Integration

4.2.1 Equality, diversity, cohesion and integration requirements are addressed as part of individual capital scheme and programme approvals. The borrowing to deliver these capital schemes is executed through treasury strategy and as such there are no further equality diversity cohesion and integration issues.

4.3 Council Policies and City Priorities

4.3.1 Treasury Management strategy secures funding to support the Council's Policies and City Priorities as set out in the Council capital programme and is consistent with the Council's business plan.

4.4 Resources and Value for Money

4.4.1 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.

4.4.2 The updated strategy 2011/12 is forecast to delivery savings of £2.6m against the budgeted position.

4.5 Legal Implications, Access to Information and Call In

4.5.1 There are no legal, or access to information issues arising from this report. The report is subject to call in.

4.6 Risk Management

4.6.1 Execution of treasury strategy is in line with the Treasury Management Strategy and Treasury Management Policy Statement agreed by Executive board and full council in February 2011. Those documents sets out the risk parameters in which treasury strategy is executed.

5 Conclusions

5.1 The Council's level of external debt at 31st March 2011 is anticipated to be £1,609m, £14m below expectations in February 2011.

5.2 Treasury Management activity has enabled revenue savings of £6.5m to be made against £3.9m assumed in the budget. This is largely due to funding the Council's borrowing requirement from short-term loans at historic low rates and internal cash balances, in lieu of more expensive longer term funding at much higher rates.

5.3 It is anticipated that the authority will remain within the approved limits for 2011/12 as outlined in Table 3 and paragraph 3.2.3.

6 **Recommendations**

That the Executive Board:

6.1 Note the update on Treasury Management borrowing and investment strategy for 2011/12.

7 Background documents

7.1 Treasury Management Strategy 2011/12 - Executive Board 11th February 2011.

Appendix A

Leeds City Council - Prudential Indicators 2011/12 - 2013/14

No.	PRUDENTIAL INDICATOR	2011/12	2012/13	2013/14
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note1)	10.86%	12.40%	13.08%
2	HRA	13.05%	14.49%	15.85%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	159.09	187.80	202.28
4	increase in housing rent per week	0.00	0.00	0.00
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
	Estimate of total capital expenditure			
6	Non HRA	259,622	135,289	17,178
7	HRA	52,471	36,803	27,800
	TOTAL	312,093	172,092	44,978
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	992,488	1,037,841	1,009,419
9	HRA	809,397	808,105	806,795
	TOTAL	1,801,885	1,845,946	1,816,214

No.	PRUDENTIAL INDICATOR	2011/12	2012/13	2013/14
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 5)**			
	borrowing	1,900,000	1,900,000	1,900,000
	other long term liabilities	600,000	600,000	600,000
	TOTAL	2,500,000	2,500,000	2,500,000
11	**Operational boundary - (Note 5)**			
	borrowing	1,760,000	1,760,000	1,760,000
	other long term liabilities	565,000	565,000	560,000
	TOTAL	2,325,000	2,325,000	2,320,000
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 31/03/12**
	under 12 months	0%	15%	3.1%
	12 months and within 24 months	0%	20%	11.8%
	24 months and within 5 years	0%	35%	19.5%
	5 years and within 10 years	0%	40%	9.2%
	10 years and above	25%	90%	56.4%
				100.0%

otes.

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.**

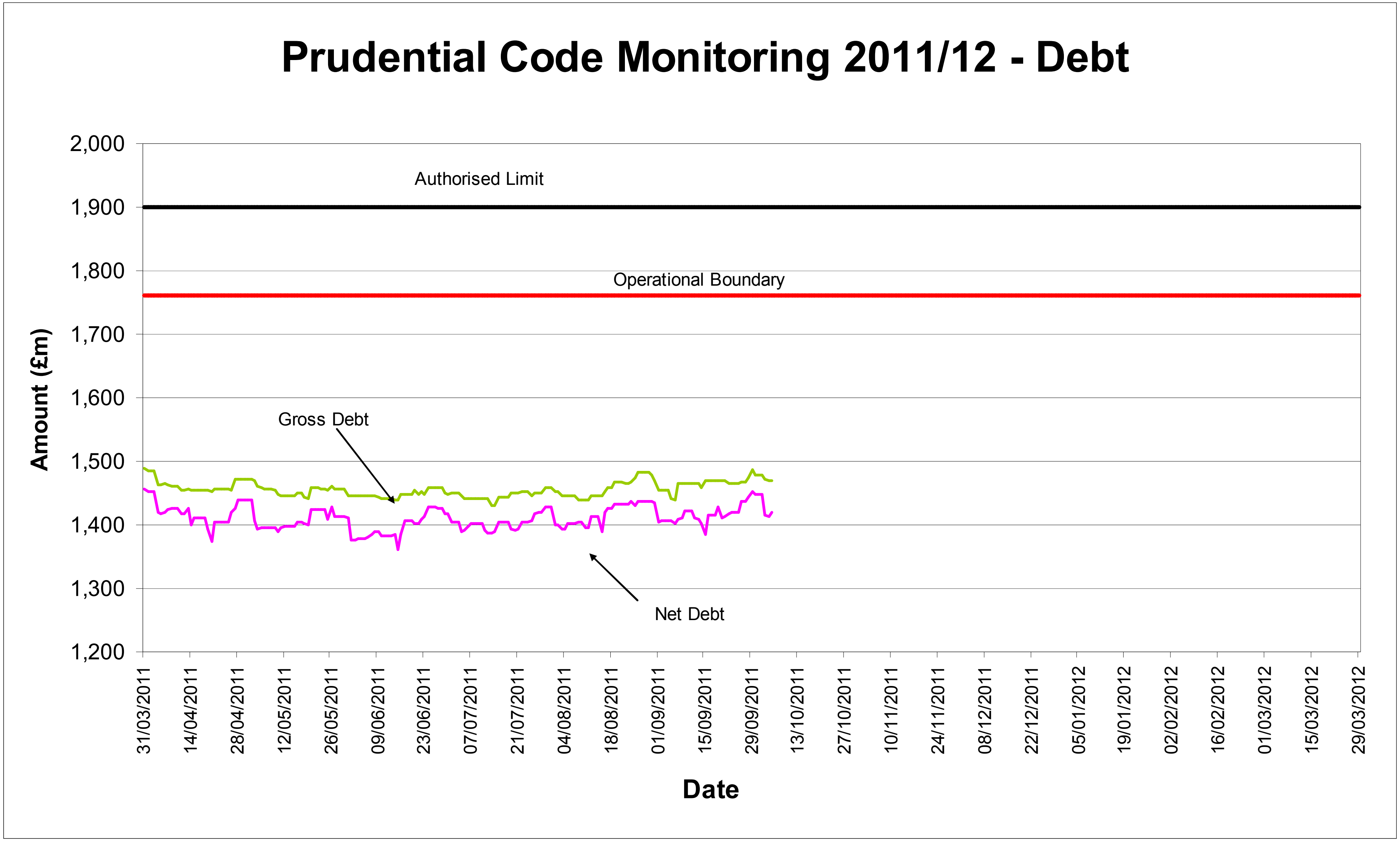
3 **In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the 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 2011/12 - Debt
Authorised Limit
Operational Boundary
Gross Debt
Net Debt
Amount (£m)
2,000
1,900
1,800
1,700
1,600
1,500
1,400
1,300
1,200
31/03/2011
14/04/2011
28/04/2011
12/05/2011
26/05/2011
09/06/2011
23/06/2011
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