Leeds CITY COUNCIL

Report author: M Taylor
Tel: 74234

Report of Director of Resources

Report to Executive Board

Date: 7th November 2012

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2012/13

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 2012/13.

2. The Council's level of external debt as at 31st March 2013 is anticipated to be £1,515m, £25m lower than approved in February 2012. The level of debt is expected to remain within the Authorised limit for external debt as agreed by Council on 10th February 2012.

3. Monitoring of money and financial markets has enabled forecast revenue savings of £400k, or £1.5m if the budgeted savings target of £1.1m is included. These projections are subject to the conclusion of the split of debt between HRA and General Fund under the new HRA self financing scheme. The generation of this saving is largely due to continuing to fund the borrowing requirement from short-term loans at historic low rates and internal cash balances.

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.

Recommendations

5. That the Executive Board note the update on Treasury Management borrowing and investment strategy for 2012/13.

1 Purpose of this report

1.1 The 2012/13 treasury management strategy was approved by Executive Board on 10th February 2012. This report provides a review and update of the strategy for 2012/13.

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 and 2011) 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 2012/13

3.1.1 The current borrowing forecasts are shown in Table 1

Table 1

ANALYSIS OF BORROWING 2012/13		2012/13 Feb 12 Report £m	2012/13 This Report £m
Net Borrowing at 1 April		1,593	**1,385**
New Borrowing for the Capital Programme – Non HRA		106	**120**
New Borrowing for the Capital Programme – HRA		0	**0**
Debt redemption costs charged to Revenue (Incl HRA)		(37)	**(39)**
HRA Subsidy Settlement **		(112)	**0**
Reduced/(Increased) level of Revenue Balances		(10)	**49**
Net Borrowing at 31 March*		1,540	**1,515**
Capital Financing Requirement			**1,734**
* Comprised as follows			
Long term borrowing	Fixed	1,423	**1,260**
	Variable (less than 1 Year)	50	**25**
	New Borrowing	60	**129**
Short term Borrowing		19	**112**
Total External Borrowing		1,552	**1,526**
Less Investments		12	**11**
Net External Borrowing		1,540	**1,515**
% borrowing funded by short term and variable rate loans		8%	**17%**

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

** the Feb 12 report figures have been restated to reflected the HRA self financing adjustment

3.1.2 Table 1 above shows that 2012/13 net external borrowing is now forecast at £1,515m, £25m lower than in the report to Executive Board on 11th February 2012 (post HRA adjustment).

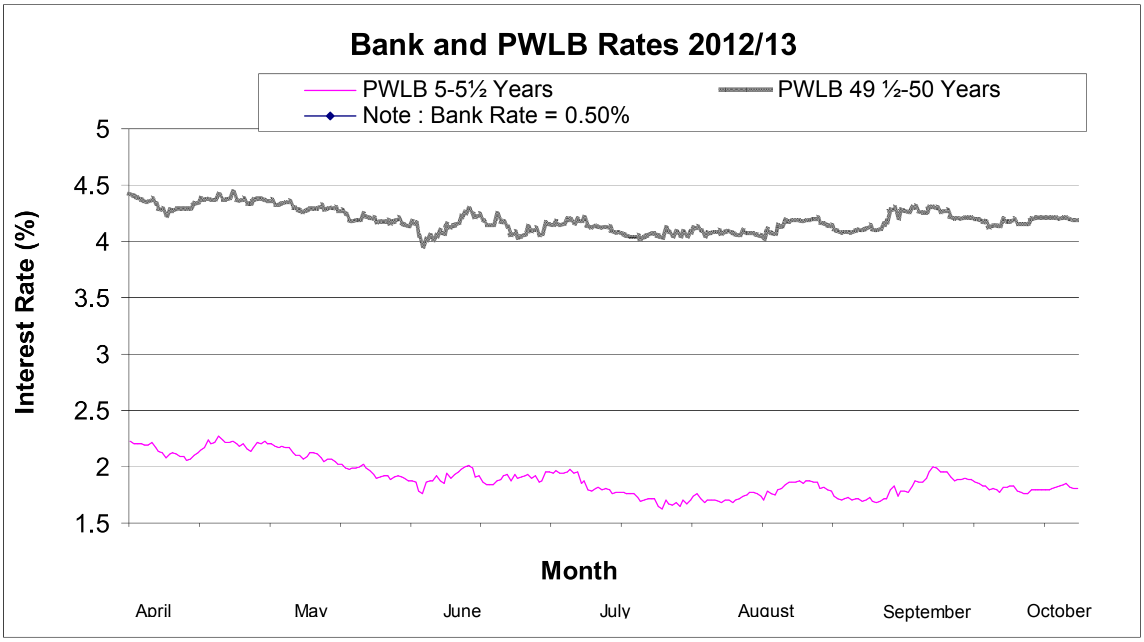
3.1.3 The financial markets and the economic conditions remain challenging in the UK, Europe and many of the emerging countries. The UK has suffered its worst and slowest recovery from recession of any of the five recessions since 1930. Furthermore the Bank of England August 2012 Inflation Report again pushed back the timing of a return to trend growth and the rate at which inflation will fall back towards the target rate of 2%. The UK's total GDP is made up of 40% reliance on overseas trade, therefore with weaker growth expect abroad the UK economy is likely to register weak growth in the next two years. UK Consumers are likely to remain focused on paying down debt together with weak consumer sentiment and job fears will all act to keep consumer expenditure suppressed. It is anticipated that it will take longer to eliminate the UK's structural budget deficit than in the current plans. A summary of major themes within the economy are:

- GDP returned to 1% growth in the third quarter after three quarters of recession;
- Retail sales held up well and spending off the high street strengthened;
- Unemployment continued to fall and currently stands at 7.9%. However Youth unemployment (16-24 year olds) stands at 20.5%.There are considerable differences between the rates of unemployment for 16-17 year olds – currently 35.5% – and those for 18-24 year olds – currently 18.5%;
- Inflation has made moderate downward progress and currently stands at 2.2%;
- The Monetary Policy Committee (MPC) announced more asset purchases;
- UK equity and government bond prices rose;
- The US economy continued to recover, but at a disappointingly slow pace.

3.1.4 Economic forecasting remains difficult with so many external influences weighing on the UK. Key areas of uncertainty include:

- The impact of the Eurozone crisis on financial markets and the banking sector;
- The impact of the UK Government's austerity plan on confidence and growth;
- Monetary policy action failing to stimulate growth in western economies;
- The potential for weak growth or recession in the UK's main trading partners - the EU and US;

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. The overall balance of risks remains weighted to the downside. The market view is that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK and other major western countries. However, near-term Quantitative Easing (QE) is likely to depress yields and further QE thereafter may lead to a reassessment of this forecast.



3.1.6 Given the weak outlook for economic growth, the prospects for any interest rate changes before early 2014 as very limited indeed. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints. The latest forecast of rates is shown in the following table.

Table 2

	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%
5yr PWLB rate	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.30%
10yr PWLB rate	2.50%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.20%	3.30%
25yr PWLB rate	3.70%	3.70%	3.70%	3.80%	3.80%	3.90%	4.00%	4.10%	4.20%	4.30%
50yr PWLB rate	3.90%	3.90%	3.90%	4.00%	4.00%	4.10%	4.20%	4.30%	4.40%	4.50%

3.1.7 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 continues to be pushed further back as economic outlook remains weak. Table 3 shows that £25m of new loans were acquired as market opportunities were taken. The Director of Resources will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time.

Table 3

New Replacement Borrowing			
Date	Amount (£m)	Term (Years)	Interest Rate (%)
PWLB			
11/05/2012	10	10	2.95
21/05/2012	10	10	2.90
	20		
Market Loans			
20/04/2012	5	22.5	3.95
	5		
Total	**25**		

3.1.8 The use of short term debt at low rates of interest and existing revenue balances continue to be used to fund the borrowing requirement and has resulted in forecast savings of £400k, or £1.5m including the budgeted treasury savings target of £1.1m. Members should note that these savings are subject to the outcome of the split of HRA debt as mentioned in below in Section 3.4 of this report.

3.2 Borrowing Limits for 2012/13, 2013/14 and 2014/15

3.2.1 The Council is required to set various limits for 2012/13, 2013/14 and 2014/15 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code (as amended 2009 and 2011). These limits including prudential indicators are detailed in Appendix A.

3.2.2 New borrowing limits for 2012/13 were approved by Council on 10th February 2012 and are set out below in Table 4.

Table 4

	2012/13 February 2012 £m	2012/13 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 2012/13. 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 Revenue Account (HRA) Changes

3.4.1 Since the introduction of the new self financing scheme for HRA ,work is nearing completion on allocating loans and interest costs between the general fund and HRA The conclusion of this work will have an impact on both General Fund and the HRA. Members are reminded that the guiding 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 Capital Financing Requirement are apportioned between General Fund and HRA.

4 Corporate Considerations

4.1 Consultation and Engagement

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

4.1.2 The borrowing requirement is an outcome of the capital programme. Consultation is undertaken by individual services in relation to capital investment schemes. A capital programme update report is included elsewhere on this agenda.

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.

4.2.2 An equality screening document is attached at Appendix C.

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 2012/13 is forecast to deliver savings of £0.4m against the budgeted position, or £1.5m if you include the budgeted treasury saving of £1.1m.

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 This report sets out the framework for the treasury strategy for the year ahead. The execution of strategy and associated risks are kept under regular review through:

- Monthly reports to the Finance Performance Group
- Monthly dashboard reporting to CLT
- Quarterly strategy meeting with the Director of Resources and the Council's treasury advisors
- Regular market, economic and financial instrument updates and access to real time market information
- Regular treasury management meetings with the Core Cities and West Yorkshire Districts.

5 Conclusions

5.1 The Council's level of external debt at 31st March 2013 is anticipated to be £1,515m, £25m below expectations in February 2012.

5.2 Treasury Management activity has enabled revenue savings of £400k. 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 2012/13 as outlined in Table 4 and paragraph 3.2.2.

6 Recommendations

6.1 Executive Board are asked to note the update on Treasury Management borrowing and investment strategy for 2012/13.

7 Background documents[1]

7.1 None

[1] The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.

Appendix A

Leeds City Council - Prudential Indicators 2012/13 - 2014/15

No.	PRUDENTIAL INDICATOR	2012/13	2013/14	2014/15
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note1)	12.36%	13.20%	13.57%
2	HRA	13.24%	12.24%	13.04%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	13.15	46.05	59.81
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	198,589	139,739	64,910
7	HRA	65,935	61,660	66,293
	TOTAL	264,524	201,399	131,203
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	1,541,110	1,554,099	1,532,527
9	HRA	710,605	762,294	828,965
	TOTAL	2,251,715	2,316,393	2,361,492

No.	PRUDENTIAL INDICATOR	2012/13	2013/14	2014/15
	(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	650,000	700,000
	TOTAL	2,500,000	2,550,000	2,600,000
11	**Operational boundary - (Note 5)**			
	borrowing	1,760,000	1,760,000	1,760,000
	other long term liabilities	565,000	610,000	665,000
	TOTAL	2,325,000	2,370,000	2,425,000
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)			

No.	Maturity structure of fixed rate borrowing 2012/13	Lower Limit	Cumulative Upper Limit	Projected 31/03/2013
16	under 12 months	0%	15%	2%
	12 months and within 24 months	0%	20%	10%
	24 months and within 5 years	0%	35%	16%
	5 years and within 10 years	0%	40%	12%
	10 years and above	25%	90%	60%
				100%

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.**

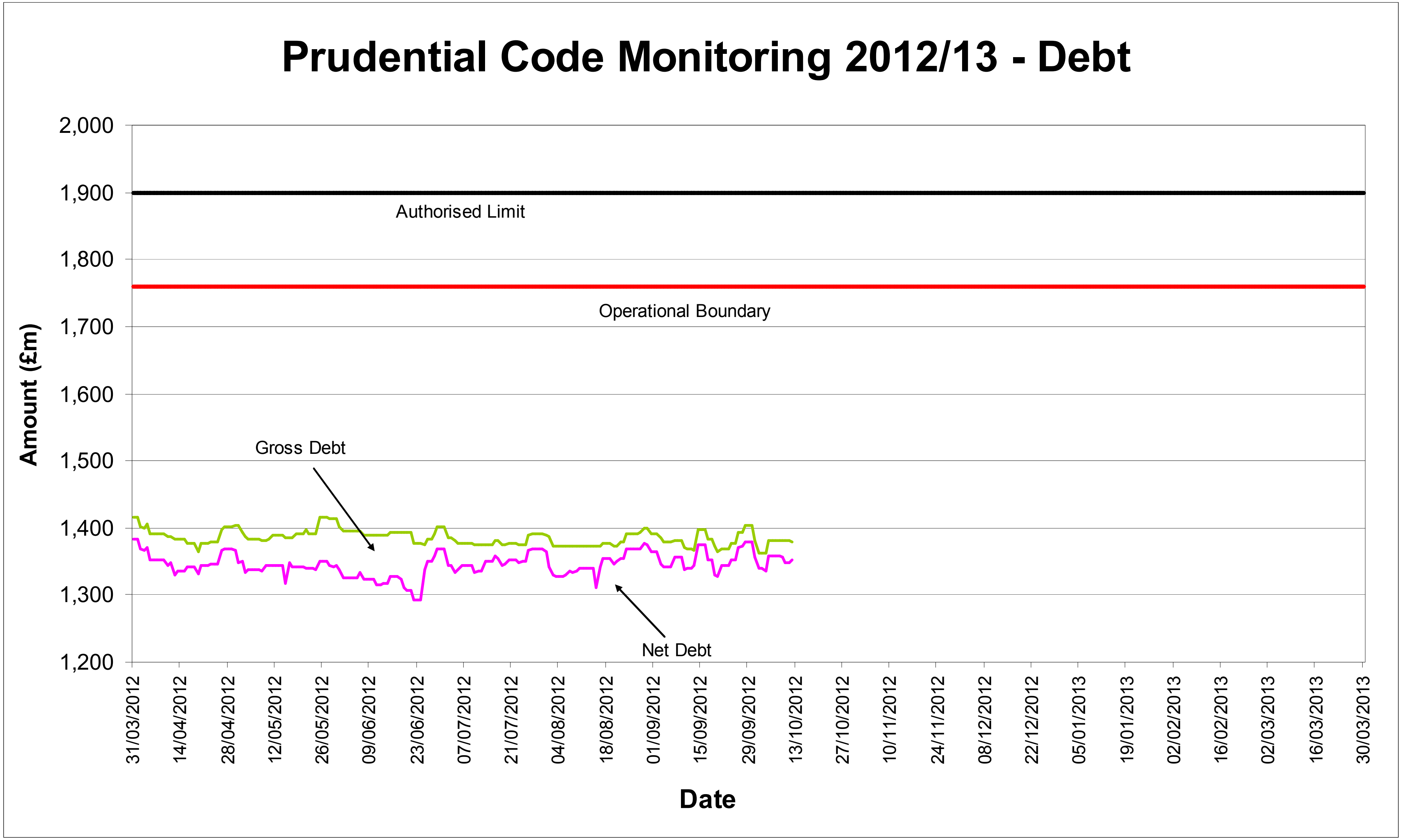
2. **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.**

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 and 2012**

Appendix B



Prudential Code Monitoring 2012/13 - Debt
2,000
1,900
1,800
1,700
1,600
1,500
1,400
1,300
1,200
Amount (£m)
Authorised Limit
Operational Boundary
Gross Debt
Net Debt
31/03/2012
14/04/2012
28/04/2012
12/05/2012
26/05/2012
09/06/2012
23/06/2012
07/07/2012
21/07/2012
04/08/2012
18/08/2012
01/09/2012
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