

MAIDSTONE BOROUGH COUNCIL

AUDIT COMMITTEE

26 NOVEMBER 2012

REPORT OF HEAD OF FINANCE & CUSTOMER SERVICES

Report prepared by John Owen
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1. TREASURY MANAGEMENT STRATEGY MID YEAR PERFORMANCE

1.1 Issue for Decision

1.1.1 This report sets out the activities of the Treasury Management function at the mid point of the 2012/13 financial year in accordance with CIPFA's Code of Practice on Treasury Management 2011. The Code suggests that members should be informed of Treasury Management activities at least twice a year.

1.1.2 This report also considers the reference from Cabinet arising from the decision made on 12th September 2012 to proposal borrowing in order to support the investment plans set out in that Cabinet decision.

1.2 Recommendation of Head of Finance & Customer Services

1.2.1 That the Audit Committee notes the position as at 30th September 2012, as detailed with the report.

1.2.2 That the Audit Committee recommends to Council the amendments proposed to the Treasury Management Strategy for 2012/13 that:

- a) the strategy includes confirmation that up to £6m can be borrowed in 2012/13 to support the capital programme;
- b) the revised prudential indicators as set out in Appendix B be approved.

1.3 Reasons for Recommendation

1.3.1 The council adopted and incorporated the CIPFA Code of Practice on Treasury Management 2011 within its Financial Regulations. The Code covers the principles and guidelines relating to borrowing and investment operations.

1.3.2 In February 2012, the council approved a Treasury Management Strategy for 2012/13. The Strategy requires members of this committee to be kept informed of Treasury Management activities through a mid year review and an annual report. In addition a brief quarterly update is given within the budget monitoring report to Cabinet.

1.3.3 The Strategy for 2012/13 set out the following objectives:-

- a) Invest funds short term (up to one year) so that funds are available to invest when rates increase.
- b) Use up to £3m core cash balances to be invested for 1 year or above if rates are at a premium over predicted base rates and funds are available for the term. This would leave a core cash balance of £2m if there were to be any unexpected events.
- c) There is no borrowing assumed within the 2012/13 Strategy.

1.3.4 In September 2012 the cabinet considered a report on investment opportunities. This included consideration of the possible use of borrowing powers to make the necessary investments through the purchase of assets. Cabinet approved the report including a proposal for borrowing up to £6m in 2012/13 and has referred that decision for consideration by this Committee. The Committee will be required to make a recommendation to Council following consideration of the proposal. The record of decision is attached at **Appendix A**.

1.4 2012/13 Overview

1.4.1 The council's current Treasury Advisors, Sector, provide the following economic overview and a rates forecast up to March 2015.

1.4.2 **Economic Overview**

The first six months of 2012/13 has shown the following:-

- Bank of England had lowered its expectations for the speed of recovery and rate of growth and has amended its forecasts for 2012 and 2013. This is particularly due to the economic effects of the continuing debt crisis of the Eurozone and worldwide developments in America and the Far East/China.
- In the UK consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on incomes from high inflation and low pay rises taking its toll.

This has been the slowest recovery from a recession of any five recessions since 1930.

- The weak recovery has caused social security payments to remain elevated and tax receipts to be depressed. The Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed back further into the future.
- However, the UK's Sovereign debt remains one of the first ports of call for surplus cash to be invested.

1.4.3 Rates Forecast

	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
3m LIBID	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	1.00	1.10	1.30	1.50	1.80
12m LIBID	1.30	1.30	1.30	1.40	1.50	1.70	1.90	2.10	2.30	2.60
5yr PWLB	1.50	1.50	1.50	1.60	1.70	1.80	1.90	2.00	2.10	2.30
10yr PWLB	2.50	2.50	2.50	2.60	2.70	2.80	2.90	3.00	3.20	3.30
25yr PWLB	3.70	3.70	3.70	3.80	3.80	3.90	4.00	4.10	4.20	4.30
50yr PWLB	3.90	3.90	3.90	4.00	4.00	4.10	4.20	4.30	4.40	4.50

- The first bank rate increase is expected to be in quarter up to December 2014.
- The above PWLB rates incorporate the introduction of the PWLB certainty Rate in November 2012 which will reduce borrowing rates by 0.20%

1.5 Annual Investment Strategy

1.5.1 The Treasury Management Strategy for 2012/13 was approved by Council in March 2012. The Council's Annual Investment Strategy, which is incorporated within the Treasury Management Strategy, outlines the council's investment priorities as follows:

- Security of Capital
- Liquidity
- Yield

1.5.2 The Council will aim to achieve optimum return on investments with proper levels of security and liquidity. It was agreed to keep investments short term with highly credit rated financial institutions, using the credit worthiness list and information provided by Sector as well as being mindful of market intelligence.

1.6 Review of Treasury Management Activity to September 2012

1.6.1 £5m has been invested with Lloyds TSB (part nationalised bank) £3m for 346 days and £2m for 367 days.

1.6.2 All other investments have been completed on a short term basis (up to one year), as agreed within the Strategy.

1.6.3 The current balance on investments as at 30th September 2012 is £28.45m. These are listed within **Appendix B**.

1.6.4 Investment income for the first half of 2012/13 has been above target. Income of £147k has been received compared to a budget of £124k with an average rate of 1.23%.

1.7 Borrowing

1.7.1 There has been no need for borrowing within the first half of 2012/13.

1.7.2 The Council has made the appropriate returns to Central Government to enable it to take advantage of the PWLB certainty rate should it need to borrow.

1.7.3 Following the decision of Cabinet referred to earlier in this report and given at Appendix A, there is a need for the Committee to consider an amendment to the current strategy and the prudential indicators. The Committee's decision on this matter would be in the form of a recommendation to Council to enable consideration of a revised Treasury Management Strategy for the current year.

1.7.4 The objectives of the current strategy, as set out in paragraph 1.3.3 of this report, include an assumption that the capital programme would not require borrowing in 2012/13. Following the Cabinet decision, borrowing is a possibility. The actual mechanism for funding the capital programme, even with the inclusion of an additional £6m of investment expenditure, may not require formal borrowing but this is dependent upon a number of factors. Should prudential borrowing prove to be the most cost effective method of financing the capital

programme then it will be necessary to have the permission to borrow clearly set out in the strategy.

1.7.5 The amendment required is therefore to include the assumed borrowing of £6m in the strategy for 2012/13.

1.8 Prudential Indicators

1.8.1 It is a statutory duty for the council to determine and keep under review the Affordable Borrowing Limits. These are listed within **Appendix C**.

1.8.2 The indicators given in the appendix include the amendments necessary to borrow up to £6m in relation to the capital programme and an additional £4m short term for cash flow purposes, making a maximum at any one time of £10m. The currently approved strategy for 2012/13 includes £4m for each value making a maximum of £8m.

1.8.3 Borrowing forms part of the two external debt indicators. These indicators are identified on the appendix as the "Operational Limit" and the "Authorised Limit". The operational limit shows only the borrowing that is long term to finance the capital programme. The value of this borrowing becomes £6m under the Cabinet proposal. If cash flow management requires short term borrowing to cover out going cash flows, the authorised limit is enforced to ensure a maximum of £4m of additional borrowing can occur short term.

1.8.4 Included within these limits, in addition to the limit for borrowing, is a limit for other long term liabilities. These are treated on the Council's balance sheet as a form of borrowing and must be included in these limits. The value of £6.2m shown relates to the agreement with Serco Paisa for the improvements to the Leisure Centre and will be a reducing liability for 15 years from the commencement of the works. This value is reduced each year in line with the agreement to ensure the Council does not incur further liabilities without the necessary approval of Members.

1.8.5 The amendment required is therefore to increase the operational limit and the authorised limit by the additional £2m required.

1.9 Cash Management

1.9.1 The major element of the council's Treasury Management function is the management on the daily basis of the cash requirements of the council. The policy objectives in this respect are:-

- The minimisation of the daily credit bank balance. Subject to clearance of monies overnight;
- Interest earned on investments should be maximised subject to **security** of funds being paramount;
- Interest paid on borrowing should be minimised;
- Adequate funds should be available to meet precept payments and other payments as they fall due;
- Cash management activities are carried out in accordance with the agreed Treasury Management Strategy.

1.9.2 The management of the Council's cash balances has been carried out entirely in accordance with the Strategy.

1.10 Alternative Action and why not Recommended

1.10.1 No alternative action is proposed relating to the historic activity covered in this report.

1.11 Impact on Corporate Objectives

1.11.1 The Treasury Management Strategy will impact upon all corporate objectives through the resource it provides from the investment of the council's balances. These resources are incorporated in the council's budget.

1.12 Risk Management

1.12.1 Risk Management is included within the Treasury Management Practices which the council adheres to. The main risks to the council are counterparty risk, liquidity risks and interest rate risks which are closely monitored on a regular basis using the council's treasury advisors, Sector, and other market intelligence. If there is a possibility of a negative risk, the appropriate action is taken.

1.12.2 The risks related to the cabinet decision on investment opportunities are set out in the original report and the decision at Appendix A. The ultimate mitigation of these risks is the proposal to set aside £0.5m from balances to cover the potential costs of scheme failure.

1.13 Other Implications

1.13.1

1. Financial

X

- 2. Staffing
- 3. Legal
- 4. Equality Impact Needs Assessment
- 5. Environmental/Sustainable Development
- 6. Community Safety
- 7. Human Rights Act
- 8. Procurement
- 9. Asset Management

X

1.14 Relevant Documents

1.14.1 Appendices

- Appendix A – Record of Decision of the Cabinet – Investment opportunities
- Appendix B – Proposed Prudential Indicators
- Appendix C – List of Investments at 30th September 2012

<u>IS THIS A KEY DECISION REPORT?</u>			
Yes	<input type="checkbox"/>	No	<input type="checkbox"/>
If yes, when did it first appear in the Forward Plan?			
.....			
This is a Key Decision because:			
.....			
Wards/Parishes affected:			
.....			