DECISION-MAKER:	GOVERNANCE COMMITTEE COUNCIL
SUBJECT:	TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS MID YEAR REVIEW
DATE OF DECISION:	25 SEPTEMBER 2012 14 NOVEMBER 2012
REPORT OF:	HEAD OF FINANCE AND IT (CHIEF FINANCIAL OFFICER)
STATEMENT OF CONFIDENTIALITY	
NOT APPLICABLE	

BRIEF SUMMARY

The Council approved a number of indicators at its meeting of the 15 February 2012. Following the September update of the Capital Programme and an analysis of Treasury Management activity in 2011/12 and between April and August 2012 these have been reviewed for 2012/13 and are reported in accordance with CIPFA's code of practice on Treasury Management and in line with the approved Treasury Management Strategy.

The core elements of the 2012/13 strategy are :

- To make use of short term variable rate debt to take advantage of the continuing current market conditions of low interest rates.
- To constantly review longer term forecasts and to lock in to longer term rates through a variety of instruments as appropriate during the year, in order to provide a balanced portfolio against interest rate risk.
- To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio.
- To invest surplus funds prudently, the Council's priorities being:
  - Security of invested capital
  - Liquidity of invested capital
  - An optimum yield which is commensurate with security and liquidity.
- To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries.

RECOMMENDATIONS:

Governance Committee is recommended to

(i) Note the current and forecast position with regards to these indicators and to endorse any changes.

(ii) Note that the continued proactive approach to Treasury Management has led to reductions in borrowing costs and safeguarded investment income.

(iii) Note changes to the 2011/12 Capital Financing Requirement to that reported in the Outturn report due to an amendment to the funding of the programme with a reduction in capital contributions and a corresponding increase in borrowing.

Council is recommended to

(i) Approve any changes to the Council's Prudential Indicators as detailed within the report.

(ii) Continue to delegate authority to the Chief Financial Officer, following consultation with the Cabinet Member for Resources to approve any changes to the Prudential Indicators or borrowing limits that will aid good treasury management. For example increase the percentage for variable rate borrowing to take advantage of the depressed market for short term rates. Any amendments will be reported as part of quarterly financial and performance monitoring and in revisions to this strategy.

(iii) Note that the continued proactive approach to TM has led to reductions in borrowing costs and safeguarded investment income.

(iv) Note changes to the 2011/12 Capital Financing Requirement to that reported in the Outturn report due to an amendment to the funding of the programme with a reduction in capital contributions and a corresponding increase in borrowing.

REASONS FOR REPORT RECOMMENDATIONS

1. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators on an annual basis and to report on them mid year and at year end.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED:

2. None.

DETAIL (Including consultation carried out):

CONSULTATION

3 The capital update report on which this report is based have been subject to their own consultation processes.

BACKGROUND

4. The Local Government Act 2003 introduced a system for borrowing based largely on self-regulation by local authorities themselves. The basic principle of the new system is that local authorities will be free to borrow as long as their capital spending plans are affordable, prudent and sustainable. A Glossary of Treasury Terms is attached as Appendix 1 for reference.

5. CIPFA has defined Treasury Management as:

"the management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

6. The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk is the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council. The main risks to the Council's treasury activities are:

- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels and thereby in the value of investments).
- Inflation Risks (Exposure to inflation)
- Credit and Counterparty Risk (Security of Investments)
- Refinancing Risks (Impact of debt maturing in future years).
- Legal & Regulatory Risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

7. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management. To aid the Council in carrying out its TM function, it has appointed TM Advisors (Arlingclose), who advise the Council on strategy and provide market information to aid decision making. However it should be noted that the decisions are taken independently by the CFO taking into account this advice and other internal and external factors.

8. All treasury activity will comply with relevant statue, guidance and accounting standards.

COMPLIANCE WITH PRUDENTIAL INDICATORS

9. All indicators to date complied with the Prudential Indicators approved by Council on 15 February 2012.

http://www.southampton.gov.uk/modernGov/ieListDocuments.aspx?CId=122&MId=2031&Ver=4

Details of the performance against key indicators and proposed changes are shown below:

Capital Financing Requirement and Actual External Debt

10. The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the CFR in the preceding year, plus the estimates of any additional capital financing requirement for the current and next two financial years. It differs from actual borrowing due to decisions taken to use internal balances and cash rather than borrow. The table below shows the actual position as at 31 March 2012 and the estimated position for the current and next two years based on the capital programme submitted to council on the 12 September 2012.

11. It should be noted that there has been an increase in the CFR compared to that reported within the outturn report submitted to Council on the 11 July 2012. This is due to a reduction in funding from contributions accounted for in the year and a corresponding increase in borrowing following an amendment made as part of the audit of the 2011/12 accounts. There is provision within the revenue budget for these borrowing costs.

Capital Financing Requirement	**2011/12 Actual £M**	**2012/13 Approved Estimate £M**	**2012/13 Estimate £M**	**2013/14 Estimate £M**	**2014/15 Estimate £M**
Balance B/F	**360**	**444**	**445**	**448**	**450**
Capital expenditure financed from borrowing	21	15	13	12	13
HRA Debt buyout	74	(8)	0	0	0
Revenue provision for debt Redemption.	(7)	(8)	(7)	(8)	(8)
Movement in Other Long Term Liabilities	(2)	(2)	(3)	(2)	(2)
Cumulative Maximum External Borrowing	**445**	**441**	**448**	**450**	**453**

Capital Financing Requirement	**2011/12 Actual £M**	**2012/13 Approved Estimate £M**	**2012/13 Estimate £M**	**2013/14 Estimate £M**	**2014/15 Estimate £M**
General Fund	271	265	274	273	272
HRA	174	176	174	177	181
Total CFR	**445**	**441**	**448**	**450**	**453**

The above limits are set to allow maximum flexibility within TM, for example a full debt restructure. Actual borrowing as shown in the tables below is significantly below this and reflects decisions taken to use internal balances and cash rather than to physically borrow and shows the position at a point in time. No new borrowing is expected to take place until the second half of the financial year.

	Balance on 01/04/2012 £M	**Debt Maturing or Repaid £M**	**New Borrowing £M**	**Balance as at 31/8/2012 £M**	**Increase/ (Decrease) in Borrowing £M**
Short Term Borrowing	0	0	0	0	0
Long Term Borrowing	300	(5)	0	295	(5)
Total Borrowing	**300**	**(5)**	**0**	**295**	**(5)**

	Balance on 01/04/2012 £M	**Balance as at 31/8/2012 £M**	**2012/13 Estimate £M**	**2013/14 Estimate £M**	**2014/15 Estimate £M**
Borrowing	300	295	352	355	352
Other Long Term Liabilities	72	72	74	78	83
Total Borrowing	**372**	**367**	**426**	**433**	**435**

Authorised Limit and Operational Boundary for External Debt

12. The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Council's ***Affordable / Authorised Borrowing Limit*** was set at £911M for 2012/13 (£832M for borrowing and £79M for other long term liabilities).

13. The ***Operational Boundary*** is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2012/13 was set at £869M (£794M for borrowing and £75M for other long term liabilities).

14. The Chief Financial Officer (CFO) confirms that there were no breaches to the Authorised Limit and the Operational Boundary and during the period to the end of August 2012, borrowing at its peak was £300M and there is no proposal to change these limits at this time.

Upper Limits for Fixed and Variable Interest Rate Exposure

15. These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2012/13 %
Upper Limit for Fixed Rate Exposure	100
Compliance with Limits:	Yes
Upper Limit for Variable Rate Exposure	50
Compliance with Limits:	Yes

16. The Upper limit represents the maximum proportion of borrowing which is subject to variable rate interest and was set at 50%, although in practice it would be unusual for the exposure to exceed 25% based on past performance, the highest to date is 15%. The limit was set at a higher level to allow for a possible adverse cash flow position, leading to a need for increased borrowing on the temporary market and to take advantage of the low rates available through the PWLB for variable debt. There has been no adverse cash flow to date but it is proposed that the limit remain at 50%, to allow for flexibility in case of any slippage in expected capital receipts.

Maturity Structure of Fixed Rate Borrowing

17. This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

	Lower Limit %	Upper Limit %	Actual Fixed Debt as at 31/8/2012 £M	Average Fixed Rate as at 31/8/2012 %	% of Fixed Rate as at 31/8/2012	Compliance with set Limits?
Under 12 months	0	45	10	2.67	4.13	Yes
12 months and within 24 months	0	45	3	1.97	1.19	Yes
24 months and within 5 years	0	50	0	0.00	0.00	Yes
5 years and within 10 years	0	75	99	3.23	39.52	Yes
10 years and within 15 years	0	75	0	0.00	0.00	Yes
15 years and within 20 years	0	75	0	0.00	0.00	Yes
20 years and within 25 years	0	75	0	0.00	0.00	Yes
25 years and within 30 years	0	75	10	4.68	3.97	Yes
30 years and within 35 years	0	75	5	4.60	1.99	Yes
35 years and within 40 years	0	75	25	4.62	9.93	Yes
40 years and within 45 years	0	75	53	3.61	21.01	Yes
45 years and within 50 years	0	75	46	0.35	18.25	Yes
50 years and above	0	100	0	0.00	0.00	Yes
			252	**3.47**	**100.00**	

Please note: the TM Code Guidance Notes (page 15) states:

"The maturity of borrowing should be determined by reference to the earliest date on which the lender can require payment. If the lender has the right to increase the interest rate payable without limit, such as in a LOBO loan, this should be treated as a right to require payment".

For this indicator, the next option dates on the Council LOBO loans will therefore determine the maturity date of the loans.

Total principal sums invested for periods longer than 364 days

18. This indicator allows the Council to manage the risk inherent in longer term investments and the limit for 2012/13 was set at £50M. Due to the current uncertainly in the market no more investments will be made unless the markets settle down and our advisors recommend it.

HRA Limit on Indebtedness

19. Local authorities are required to report the level of the HRA CFR compared to the level of debt which is imposed (or subsequently amended) by the DCLG at the time of implementation of self-financing. The following tables show this plus the movement in year.

HRA Limit on Indebtedness	2011/12 Actual £m	2012/13 Estimate £m	2012/13 Revised £m	2013/14 Revised £m	2014/15 Revised £m
HRA Debt Cap (as prescribed by CLG)	199.6	201.3	199.6	199.6	199.6
HRA CFR	174.2	175.5	174.2	177.5	181.4
Difference	**25.4**	**25.8**	**25.4**	**22.1**	**18.2**

HRA Summary of Borrowing	2012/13 Estimate £m	2012/13 Revised £m	2013/14 Revised £m	2014/15 Revised £m
Brought Forward	174.2	174.2	171.7	177.5
Maturing Debt	(8.6)	(8.6)	(8.8)	(5.4)
New borrowing	4.8	6.1	14.6	9.3
Carried forward	**170.4**	**171.7**	**177.5**	**181.4**
HRA Debt Cap (as prescribed by CLG)	201.3	199.6	199.6	199.6
Headroom	**30.9**	**27.9**	**22.1**	**18.2**

Ratio of Financing Costs to Net Revenue Stream

20. This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The definition of financing costs is set out at paragraph 87 of the Prudential Code. The ratio is based on costs net of investment income. The increase in the HRA financing costs is due to the reform of HRA of council housing finance which took effect from 28 March 2012.

Ratio of Financing Costs to Net Revenue Stream	2011/12 Actual %	2012/13 Approved %	2012/13 Estimate %	2013/14 Approved %	2014/15 Approved %
General Fund	6.30	6.84	6.47	7.42	7.17
HRA	4.65	10.92	8.98	11.05	10.84
Total	**7.12**	**8.84**	**8.13**	**9.36**	**8.93**

SUMMARY

21. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity up to the 31 August 2012. As indicated in this report none of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

22. In addition to the CIPFA's requirement to produce a mid and year end report, each quarter as part of corporate monitoring a summary of Treasury Management activity is prepared. This is presented to Cabinet as part of the Quarterly Revenue Financial Monitoring report and is available in Members Rooms.

RESOURCE IMPLICATIONS

Capital/Revenue

23. The Capital implications were considered as part of the Capital Update report submitted to Council on the 12 September 2012.

24. The revenue implications are considered as part of ongoing monitoring which is reported to Cabinet each Quarter and as part of the budget setting process.

Property/Other

25. None

LEGAL IMPLICATIONS

Statutory Power to undertake the proposals in the report:

26. Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System. From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1)(a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.

Other Legal Implications:

27. None

POLICY FRAMEWORK IMPLICATIONS

28. This report has been prepared in accordance with CIPFA's Code of Practice on Treasury Management

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SUPPORTING DOCUMENTATION

Non-confidential appendices are in the Members' Rooms and can be accessed on-line

Appendices

1.	Glossary of Treasury Terms

Documents In Members' Rooms

1.	QUARTERLY TREASURY MANAGEMENT REPORT – MONTH 3

Integrated Impact Assessment

Do the implications/subject/recommendations in the report require an Integrated Impact Assessment to be carried out.	No

Other Background Documents

Title of Background Paper(s)		Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)
1.	ANNUAL TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS 2012/13 TO 2014/15 – Council 15 February 2012	
2.	REVIEW OF PRUDENTIAL LIMITS AND TREASURY MANAGEMENT OUTURN 2011/12 – Council 11 July 2012	

Integrated Impact Assessment and Other Background documents available for inspection at:

WARDS/COMMUNITIES AFFECTED:	N/A