EXETER CITY COUNCIL

SCRUTINY COMMITTEE – RESOURCES
23 NOVEMBER 2011

EXECUTIVE
6 DECEMBER 2011

COUNCIL
13 DECEMBER 2011

TREASURY MANAGEMENT – 2011/12 – HALF YEAR UPDATE

1. PURPOSE OF REPORT

1.1 To report on the current performance for the 2011/12 financial year and the position regarding investments and borrowings at 30 September 2011.

2. TREASURY MANAGEMENT STRATEGY

2.1 The Council approved the 2011/12 treasury management strategy at its meeting on 22 February 2011. The Council's stated investment strategy was to continue to use Investec for longer term investments and utilise our call accounts and major banks and local authorities. The Council's stated borrowing strategy was to maintain short-term borrowing as long as rates remained low. The Council is currently borrowing for periods of up to 364 days only.

2.2 The Head of Treasury Services can confirm that all treasury management activity undertaken during the period complied with the approved strategy, the *CIPFA Code of Practice*, and the relevant legislative provisions.

3. ECONOMIC REVIEW

3.1 The first half of the financial year saw deteriorating expectations for global economic growth and continued concern about sovereign creditworthiness, causing financial market volatility in August and September. Long-term gilt yields fell by a full percentage point to around 3.50%.

3.2 Many Western developed nations, including the UK, implemented policies to reduce public budget deficits, which unsurprisingly curbed domestic demand. At the same time, many economies were suffering from high inflation due to stubbornly high commodity prices; this prompted the European Central Bank (ECB) to raise interest rates in April and July.

3.3 The Eurozone sovereign debt crisis continues to be a significant influence on financial markets, with investors fearing the consequences of a sovereign default on the financial system. Despite the initial bailouts of Greece, Ireland and Portugal, the crisis has continued with a second bailout of Greece required to avoid defaulting in the near future.

3.4 In the UK, the coalition government implemented its fiscal consolidation plan and despite the continuing low confidence and subdued domestic spending, inflation remains high due to the rise in VAT and higher food, energy and petrol prices. The Bank of England, however, was more concerned about the deteriorating economic outlook, and maintained Bank Rate at 0.5%, resisting pressure to increase rates to bring inflation back to target more quickly.

4. Interest Rate Prospects

4.1 The overriding concern for the Bank of England is the weakening economic outlook. Forecasts for the UK recovery include an improvement in the country's net trade position, but slowing global growth means that the boost to the economy from this avenue is less assured. Domestic spending is highly likely to remain subdued, as disposable income is eroded by higher inflation, taxes and energy prices, and low wage growth. The Bank has, during October 2011 resumed its programme of quantitative easing to boost economic growth. Most financial forecasters do not expect the first rise in Bank Rate to be before 2013. The latest interest rate forecast from the Council's treasury management advisers, Sterling Consultancy Services is shown below and demonstrates that they believe there will be a rise in Bank Rate during the second half of next year:

	SCS Central forecast					**Market forecast**	
	Bank Rate	*1 month LIBOR*	*3 month LIBOR*	*12 month LIBOR*	*25 year PWLB*	*Bank Rate*	*3 month LIBOR*
Current	**0.50**	**0.69**	**0.94**	**1.71**	**4.56**	**0.50**	**0.92**
Q4 2011	0.50	0.70	0.95	1.75	4.75	0.50	0.92
Q1 2012	0.50	0.65	0.90	1.70	4.80	0.50	0.97
Q2 2012	0.50	0.65	0.85	1.65	4.80	0.50	0.88
Q3 2012	0.75	0.80	0.95	1.75	4.80	0.50	0.88
Q4 2012	0.75	0.85	1.05	1.80	4.90	0.50	0.92
H1 2013	1.25	1.35	1.50	2.25	5.00	0.50	1.05
H2 2013	1.75	1.85	2.00	2.75	5.10		1.31
H1 2014	2.25	2.35	2.50	3.25	5.20		1.61

5. NET INTEREST POSITION

5.1 The General Fund shows an estimated net reduction in interest receivable compared to the budget, the position is:

	Estimate £	Sept 11 £	Estimated Outturn £	Variation £
Interest paid	120,000	37,676	79,000	(41,000)
Interest earned				
Interest from portfolio	(120,000)	0	0	120,000
Temporary investment interest	(40,000)	(15,925)	(20,000)	20,000
Other interest earned	(2,000)	(1,025)	(2,050)	(50)
Less				
Interest to HRA	117,780	35,000	70,000	(47,780)
Interest to s106 agreements	17,700	2,938	5,875	(11,825)
Interest to Trust Funds	6,520	1,088	2,175	(4,345)
Lord Mayors Charity	0	250	500	500
GF interest received	(20,000)	22,326	56,500	76,500
Net interest	100,000	60,002	135,500	35,500

5.2 The reduction against budget has been caused by a number of factors. Please see section 6 for a detailed explanation.

6. INVESTMENT INTEREST

6.1 The Council closed its investment portfolio held by Investec in February 2011, which was after the date that the budget for investment interest was set. This has therefore meant that there is a reduction in investment interest earned against the estimate. However this has been partially off-set by lower borrowing costs. A recent decision by credit agencies to downgrade the Royal Bank of Scotland and Lloyds Banking Groups means that the Council can no longer hold as much cash in our call accounts. We are therefore utilising the Government's Debt Management Office account in line with the treasury management strategy. However this pays a much lower interest rate of 0.25%.

6.2 The HRA interest is calculated according to statute, and has changed to reflect the lower returns.

7. ICELANDIC INVESTMENTS

7.1 On 28 October 2011 the Icelandic Supreme Court upheld the decision of the Icelandic District Court. The decision means that the deposits placed by the test case UK local authorities have priority status in the winding up of the Icelandic banks, Landsbanki and Glitnir. We however still await confirmation from the winding up boards of both banks that they will apply the Supreme Court decision to the non-test cases of which Exeter is part.

8. BORROWINGS

8.1 The Council has reduced its temporary borrowing over the first six months of the year and as such now has only £10.5 million of borrowing down from £15 million at the start of the year. Subject to the final outcome of the Icelandic court case, it is anticipated that this will reduce slightly by the end of the year as debt is repaid. The most recent borrowing has been taken over 364 days as interest rates remain very low. The Council continues to have no long term debt.

9. AMENDMENT TO THE COUNCIL'S OPERATIONAL BOUNDARY AND AUTHORISED LIMIT FOR BORROWING

9.1 The Government intends to introduce a self-financing regime for the Housing Revenue Account (HRA). As part of the arrangements to remove HRA subsidy, the Council will be required to pay the Government an amount of money (currently £58.5 million) to "buy" itself out of the subsidy system. The final amount will be confirmed in January 2012 but could be significantly higher and the payment will have to be made on 28 March 2012. The Council will therefore have to undertake long term borrowing in order to be able to afford to pay this sum to the Government.

9.2 From a Treasury Management perspective, an analysis will be undertaken to ensure that repayments are affordable and in line with the HRA Business Plan. However, the Prudential code indicators adopted by the Council in February 2011, set an Operational Boundary and Authorised Limit for the maximum level of borrowing that the Council can undertake. As this borrowing will be required during this financial year, it is necessary to increase the level of these two indicators for 2011/12.

9.3 It is proposed therefore that both the Operational Boundary and the Authorised Limit are increased by £80 million to ensure that any increases in the amount to be paid to Government will be covered by this approval. The Operational Boundary for 2011/12 will therefore become £115 million and the Authorised Limit £120 million. Future year's indicators will be approved as usual with the main budget papers in February 2012.

10. FUTURE POSITION

10.1 Short term borrowing remains at historically low levels and therefore the Council will continue to utilise this in the short term. Conversely, short term investment opportunities remain limited and the recent decision by Fitch to reduce the credit ratings of Royal bank of Scotland and Lloyds banking groups has limited the ability to use our call account facilities at these two banks. This will have an ongoing impact on returns but maximises the security of our cash.

11. RECOMMENDATION

11.1 That the Treasury Management report for the first six months of 2011/12 be noted.

11.2 That Council approves the amendments to the Council's Operational Boundary and Authorised Limit to allow the Council to borrow the funds required for the HRA self-financing regulations.

HEAD OF TREASURY SERVICES

CORPORATE SERVICES DIRECTORATE

Local Government (Access to Information) Act 1985 (as amended)
Background papers used in compiling the report:
None