	Council 19 November 2012 **Report from the Deputy Director of Finance**
	Wards Affected: ALL
2012/13 Mid–Year Treasury Report	

1. SUMMARY

1.1 This report updates members on recent treasury activity.

2. RECOMMENDATION

2.1 The Council is asked to note the 2012/13 mid-year Treasury report.

3. DETAIL

BACKGROUND

3.1 The Council's Treasury Management Strategy has been underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management 2009, which includes the requirement for determining a treasury strategy on the likely financing and investment activity for the forthcoming financial year.

3.2 The Code also recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

3.3 Treasury Management is defined as: "The management of the local authority'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."

ECONOMIC BACKGROUND

3.4 Growth rates have fallen across the world in the last six months. The US and Germany continue to grow slowly, but the UK and most European economies have returned to or entered recession. Even the higher performing economies of the Far East and South America are experiencing reduced growth. This global slowdown has kept inflation largely under control, and it is falling quite rapidly in the UK as many of last year's price rises pass through the figures.

3.5 Gilt yields fell sharply raising the prospect that very short-dated yields could turn negative. 2-year yields fell to 0.06%, 5-year yields to 0.48% and 10-year yields to 1.45%. Despite the likelihood the Debt Management Office would revise up its gilt issuance for 2012/13, there were several gilt-supportive factors: the Bank of England's continued purchases of gilts under an extended Quantitative Easing (QE) programme; investors preferring the safer haven of UK government bonds to those of European sovereigns; the coalition's commitment to fiscal discipline by sticking to its "plan A" for deficit reduction; large scale purchases by banks to comply with the Financial Services Authority's liquidity buffer requirements; and general risk aversion against a weak economic backdrop. Borrowing rates offered by the Public Works Loans Board (PWLB) to councils fell commensurately.

3.6 Money market rates fell over the six month period by between 0.2% and 0.6% for 1-12 month maturities.

DEBT MANAGEMENT

3.7 The PWLB remains an attractive source of borrowing for the Council as it offers flexibility and control. In August HM Treasury announced details of the "Certainty Rate" which will enable "eligible authorities" to access cheaper PWLB funding, with a 20 basis point reduction on the standard PWLB borrowing rate. Initially announced in the March 2012 Budget, HM Treasury have introduced this initiative to incentivise local authorities to provide robust forecasts on borrowing plans. This rate will be introduced in November 2012, and Brent has been accepted to receive it.

3.8 Alternative borrowing sources: Alternative sources of long term funding to long-dated PWLB borrowing are available, but the Council will continue to adopt a cautious and considered approach to funding from the capital markets as the simplicity and ease of dealing with the PWLB represents a strong advantage. Two long term loans of £10m each have been raised so far this year as is shown in the table below:

	Balance on 01/04/2012 £m	Debt Repaid £m	New Borrowing £m	Balance on 30/09/2012 £m
Short Term Borrowing	26.3	44.3	18.0	0.0
Long Term Borrowing	405.5	1.2	20.0	424.3
TOTAL BORROWING	431.8	45.5	38.0	424.3
Average Rate %	4.45			4.71

3.9 No debt rescheduling has been considered in the last half year as present discount rates make the premia involved unattractive.

INVESTMENT ACTIVITY

3.10 The Council gives priority to security and liquidity and aims to achieve a yield commensurate with these principles.

	Balance on 01/04/2012 £m	Investments Made £m	Investments Repaid £m	Balance on 30/09/2012 £m
Short Term Investments	43.8	1,520.7	1,495.1	69.4

3.11 Security of capital has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2012/13. New investments were made with the following institutions:

Other Local Authorities;
AA- rated banks;
AAA rated Money Market Funds;
The UK Debt Management Office.

3.12 Counterparty credit quality was assessed and monitored with reference to Credit Ratings (the Council's minimum long-term counterparty rating of AA- (or equivalent) across rating agencies Fitch, Standard & Poors and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; sovereign support mechanisms; potential support from a well-resourced parent institution; share price.

BUDGETED INCOME AND OUTTURN

3.13 The Council's budgeted investment income for the year has been estimated at £0.1m. The average cash balances, representing the Council's reserves and working balances, were £95m during the period. At present, the Council appears likely to achieve this figure.

3.14 The UK Bank Rate has been maintained at 0.5% since March 2009 and is not expected to rise until 2015/2016. Short-term money market rates have remained at very low levels.

ICELANDIC BANK INVESTMENT UPDATE

3.15 The following has now been resolved in relation to Icelandic deposits:

Iceland-Domiciled Banks

3.16 On 28 October 2011 the Icelandic Supreme Court ruled that UK local authority claims in the administrations of Glitnir and Landsbanki qualified as priority claims under Icelandic bankruptcy legislation, confirming the earlier decision of the Reykjavik District Court.

3.17 This means that the values of local authorities' claims in the Icelandic administrations qualifying for priority settlement are now final and will, at the very least, be equal to the value of the original deposit plus interest accrued to the maturity date. After the decision of the Icelandic Supreme Court had been delivered, the Winding Up Board of Glitnir made a distribution to priority creditors, which included local authorities. This was accepted by all UK local authorities and implemented on 16 March 2012. The distribution currencies were Icelandic kroner, Euros, US dollars, pounds sterling, and Norwegian krona. The Icelandic kroner are held in an interest bearing account in Iceland pending the lifting of exchange controls. This means that, of the £5m which Brent deposited with Glitnir, £4m has now been recovered.

Non-Iceland-Domiciled Banks

3.18 It is expected that over £9m of the original £10m deposit will be recovered. Almost £7.5m has been recovered to date, and a further £0.5m-£0.8m is expected by 31 March 2013.

COMPLIANCE WITH PRUDENTIAL INDICATORS

3.19 The Council can confirm that it has complied with its Prudential Indicators for 2012/13, which were set in February 2012 as part of the Council's Treasury Management Strategy Statement. Details can be found in Appendix 1.

OUTLOOK

3.20 At the time of writing this activity report in October 2012, economic growth remains elusive. Tight credit conditions and weak earnings growth are constraining consumer and corporate spending. The outlook is for official interest rates to remain low for an extended period, as shown below.

	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Official Bank Rate													
Upside risk				0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

SUMMARY

3.21 In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first half of 2012/13. 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.

4. FINANCIAL IMPLICATIONS

These are covered in the report.

5 DIVERSITY IMPLICATIONS

The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

6 STAFFING IMPLICATIONS

None

7 LEGAL IMPLICATIONS

There are no legal implications arising from the report.

8 BACKGROUND

Annual Treasury Strategy – Report to Full Council (and the Audit Committee) as part of the Budget Report – February 2012.

Persons wishing to discuss the above should contact the Exchequer and Investment Section, Finance and Corporate Resources, on 020 8937 1472/74 at Brent Town Hall.

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Appendix 1

Capital Financing Requirement

Estimates of the Council's cumulative maximum external borrowing requirement for 2012/13 to 2014/15 are shown in the table below:

	31/03/2012 Actual £m	31/03/2013 Estimate £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m
CFR	537	598	594	591

Usable Reserves

Estimates of the Council's level of Usable Reserves for 2012/13 to 2014/15 are as follows:

	31/03/2012 Actual £m	31/03/2013 Estimate £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m
Usable Reserves	58	37	30	24

Prudential Indicator Compliance

Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Authorised Borrowing Limit. This is a statutory limit which should not be breached. The Council's Authorised Borrowing Limit was set at £823m for 2012/13. 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 £723m. The Deputy Director of Finance confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the year; borrowing at its peak was £432m.

Upper Limits for Fixed Interest Rate and Variable Interest Rate Exposure

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	40%
Compliance with Limits:	Yes

Interest Rate Exposures	Level at 31/03/12	2012/13 Approved	Actual 30/09/12
Fixed			
Upper Limit for Fixed Interest Rate Exposure on Debt	89%	100%	89%
Variable			
Upper Limit for Variable Interest Rate Exposure on Debt	11%	40%	11%

Maturity Structure of Fixed Rate Borrowing

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

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing as at 30/09/12 £m	% Fixed Rate Borrowing as at 30/09/12	Compliance with Set Limits?
Under 12 months	40	0	3.9	1	Yes
12 months and within 24 months	20	0	3.9	1	Yes
24 months and within 5 years	20	0	11.8	3	Yes
5 years and within 10 years	60	0	25.3	6	Yes
10 years and above	100	0	379.4	89	Yes

Gross and Net Debt

The purpose of this treasury indicator is to highlight a situation where the Authority is planning to borrow in advance of need.

Upper Limit on Net Debt compared to Gross Debt	31/3/12 Actual £m	31/3/13 Estimate £m	Limit
Outstanding Borrowing (at nominal value)	405.5	490	823
Less: Investments	43.8	20	0
Net Debt	361.7	470	823

Net Debt and the CFR

This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Authority should ensure that the net external borrowing does not exceed the total of the CFR in the preceding year plus the estimates of any additional increases to the CFR for the current and next two financial years.

The Authority had no difficulty meeting this requirement so far in 2012/13, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Total principal sums invested for periods longer than 364 days

This indicator allows the Council to manage the risk inherent in investments longer than 364 days.

The limit for 2012/13 was set at £20m.

The Council's practice since the onset of the credit crunch in 2007 has been to keep investment maturities to a maximum of 12 months. No investments were made for a period greater than 364 days during this period.

Credit Risk

This indicator has been incorporated to review the Council's approach to credit risk. The Council confirms it considers security, liquidity and yield, in that order, when making investment decisions.

Credit ratings remain an important element of assessing credit risk, but they are not the sole feature in the Authority's assessment of counterparty credit risk. The authority considers the following tools to assess credit risk:

Published credit ratings of the financial institution and its sovereign;
Sovereign support mechanisms;
Credit default swaps (where quoted);
Share prices (where available);
Economic fundamentals, such as a country's net debt as a percentage of its GDP;
Corporate developments, news, articles, markets sentiment and momentum.

The Council can confirm that all investments were made in line with a minimum long term credit rating of AA- or equivalent, as set in the 2012/13 TMSS.

HRA Limit on Indebtedness

This purpose of this indicator is for the Council to report on the level of the limit imposed at the time of implementation of self-financing by the Department for Communities and Local Government.

HRA Limit on Indebtedness	31/03/2012 Actual £m	31/03/2013 Estimate £m	31/03/2014 Estimate £m	31/03/2015 Estimate £m
HRA CFR	137	141	141	141
HRA Debt Cap (as prescribed by CLG)	199	199	199	199
Difference	62	60	60	60