Brighton & Hove City Council **Item 7 on agenda**
For General Release

Meeting:	**Finance Management Sub Committee**
Date:	**19 July 2007**
Report of:	**Director of Finance & Resources**
Subject:	**Treasury Management Policy Statement 2006/07 (incorporating the Annual Investment Strategy 2006/07) – End of year review**
Wards affected:	**All**

1 Purpose of the report and policy context

1.1 The Treasury Management Policy Statement (TMPS) and the Treasury Management Practices (including the schedules) for the year commencing 1 April 2006 were approved by Policy & Resources Committee (P&R) on 1 March 2006. The TMPS sets out the key role for treasury management, whilst the practices and schedules set out the annual targets for treasury management and the methods by which these targets shall be met. A further report to P&R on 30 November 2006 outlined the action taken during the first half of the year to meet the TMPS and practices.

1.2 The TMPS includes an annual investment strategy, which sets out the key investment parameters for council cash funds. Full Council approved the investment strategy on 16 March 2006.

1.3 The purpose of this report is to advise of the action taken during the second half of the financial year 2006/2007 on the TMPS, including the investment strategy.

2 Recommendations

2.1 That Finance Management Sub Committee endorse the action taken during the half year to meet the treasury management policy statement and practices (including the annual investment strategy);

2.2 That Finance Management Sub Committee note that the authorised limit and operational boundary set by the Council have not been exceeded.

3 Overview of markets

3.1 The 2006/07 financial year featured a rising trend in interest rates as policy makers and financial markets responded to the twin effects of strengthening activity and rising inflation. The Bank Rate set by the Bank of England has increased during the 2nd half-year from 4¾% to 5¼%.

3.2 An overview of the market is set out in Appendix 2 to this report.

4 Treasury Management Strategy

4.1 A summary of the action taken in the six months from October 2006 to March 2007 is provided in Appendix 2 to this report.

4.2 Treasury management is one of the criteria used in the comprehensive performance assessment to judge use of resources. The criteria require that "the council has a treasury management strategy that reflects the requirements of the CIPFA Code of Practice for Treasury Management in the Public Services." In 2006/07 this criteria was satisfied.

4.3 Action taken has reduced the average cost of the debt portfolio from 4.93% per annum to 4.79%pa over the year. In addition investment returns for the year have:

- in-house treasury team – exceeded the benchmark rate by an average 5 basis points (0.05%),
- cash manager – exceeded the benchmark rate by 12 basis points (0.12%)

4.4 The above performance, together with better than expected cash flow balances, has contributed towards an underspend on the financing costs budget of circa £2.1m in 2006/07. The following table summarises the areas of major underspend.

Budget 2006/07		£9,992k
<u>Impact of action taken by in-house treasury team</u>		
• debt rescheduling	- £376k	
• timing of new borrowing	- £61k	
• above benchmark performance on investments	- £59k	- £496k
<u>Impact of market factors</u>		
• higher average debt outstanding	£304k	
• higher average investment balances outstanding (e.g. cash flows)	- £1,422k	
• higher interest rates	- £476k	- £1,594k
<u>Impact of other movements</u>		£17k
Actual 2006/07		£7,939k

4.5 The two borrowing limits approved by full Council in March 2006 – the 'authorised limit' and 'operational boundary' – have not been exceeded during the year.

5 Socially responsible investments

5.1 The council continues to promote its' ethical investment strategy, especially with institutions within which it deposits money. A recent survey of a number of institutions on the council's authorised lending list suggests growing support for the council's approach on socially responsible investments.

5.2 The council's ethical investment statement is set out below:

"Brighton & Hove City Council, in making investments through its treasury management function, fully supports the ethos of socially responsible investments. We will actively seek to communicate this support to those institutions we invest in as well as those we are considering investing in by:

- *encouraging those institutions to adopt and publicise policies on socially responsible investments;*
- *requesting those institutions to apply council deposits in a socially responsible manner."*

5.3 Investment counterparties are advised of the above statement each and every time a deposit is placed with them.

Appendix 1

Meeting/Date	Finance Management Sub Committee 19 July 2007
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Financial implications

The financial implications arising from the action taken under the TMPS are included in Financing Costs. Detail of the 2006/07 outturn for financing costs are included within the draft statement of accounts 2006/07 report presented to Policy & Resources Committee on 28 June 2007.

Finance Officer consulted: Peter Sargent   Date: 30 May 2007

Legal implications

The TMPS and action under it must be in accordance with Part I of the Local Government Act 2003 and regulations issued thereunder. Relevant guidance also needs to be taken into account.

This report is for information purposes only and as such it is not considered that anyone's rights under the Human Rights Act will be adversely affected by it.

Lawyer consulted: John Heys   Date: 4 June 2007

Corporate/City-wide implications	Risk assessment
None directly arising from this report	Action taken in the six months to March 2007 is consistent with the risks identified within the TMPS and associated schedules.
Sustainability implications	**Equalities implications**
None directly arising from this report	None directly arising from this report

Implications for the prevention of crime and disorder

None directly arising from this report

Background papers
Part I of the Local Government Act 2003 and associated regulations The Treasury Management Policy Statement and associated schedules 2006/07 approved by Policy & Resources Committee on 1 March 2006 The Annual Investment Strategy 2006/07 approved by full Council on 16 March 2006 Papers held within Strategic Finance, Corporate Services. The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2003
Contact Officer Peter Sargent, Loans & Technical Manager – ☎ (01273) 291241

Appendix 2

Summary of action taken in the period October 2006 to March 2007

Market Background (courtesy of Butlers, external treasury management advisors)

The 2006/07 financial year featured a rising trend in interest rates as policy makers and financial markets responded to the twin effects of strengthening activity and rising inflation. The optimism that had prevailed in the first few months of 2006 had evaporated by the beginning of the new financial year. The rebound in economic activity since 2005 proved more robust than consensus expectations. In addition, external pressures on consumer price inflation had continued to escalate. While short-term interest rates remained steady in the first few months of the year, a steepening in the positive incline of the yield curve to 1-year and beyond highlighted growing expectations that a rise in official interest rates would eventually materialise.

The Bank Rate at the start of the half-year was 4¾% (up from 4½% in August 2006). The deteriorating inflation outlook, the economy's slow response to monetary policy tightening, a less than favourable international backdrop and concerns that deteriorating inflation expectations at home would drive prices higher prompted additional rate increases. Two one-quarter point (¼%) increases in Bank Rate were announced in November 2006 (to 5%) and January 2007 (to 5¼%). Further tightening measures were anticipated by the market, expectations that ensured the steep upward incline of the yield curve persisted and attractive investment opportunities prevailed to year- end.

Long-term PWLB interest rates charted an erratic course but the overall trend was towards higher levels. Deteriorating inflation expectations on the domestic and international fronts, in reaction to strong growth on a global basis, was the principal force driving yields higher. Strong technical demand for bonds, courtesy of the re-balancing of pension fund portfolios in favour of fixed income assets, was insufficiently strong to counter the rise in yields. Occasional rallies in the gilt-edged market cause dips in rates and presented favourable borrowing opportunities. But these were short-lived and by the close of the year, yields were trading close to the highest levels seen since early 2005.

Treasury Management Strategy

New long-term borrowing

No long-term borrowing was raised in the 2nd half of the year.

Debt maturity

Debt maturing during the 2nd half-year totalled £6.0m. This sum included a loan that was due for repayment on 30 September 2006 but was actually repaid on 1 October 2006 with the agreement of the lender (30 September being a non-banking day).

Weighted average maturity of debt portfolio

The weighted average maturity period of the debt portfolio has increased marginally during the 2nd half-year (Table 2).

Table 2 – Weighted average maturity profile – debt portfolio

Date raised	Sept 2006	Sept 2006 balance as at Mar 2007 (*)	Mar 2007 (**)
Weighted average maturity period (years)	33.01	33.36	33.36

(*) the *'Sept 2006 balance as at Mar 2007'* figure reflects the natural 'time elapse' reduction in the average period of the debt portfolio – in the above table this time elapse is offset by the deferral in repaying the £5m loan on 30 September 2006 (see 'Debt maturity' above)

(**) the weighted average maturity period as at 1 April 2006 was 21.87 years

Debt rescheduling

Market conditions, together with the extensive debt rescheduling undertaken in the six months to September 2006 resulted in no further debt rescheduling in the 2nd half-year.

Capital financing requirement

The prudential code introduces a number of indicators that compare 'net' borrowing – borrowing less investments – with the capital financing requirement (the capital financing requirement being amount of capital investment met from borrowing). Table 3 compares the capital financing requirement with net borrowing but equally as important to actual borrowing.

Table 3 – Capital financing requirement compared to debt outstanding

	30 Sept 2006	31 Mar 2007	Movement in period
Capital financing requirement (CFR)	£234.5m(*)	£232.4m	-£2.1m
Outstanding debt	£239.9m	£233.9m	-£6.0m
Investments	£113.0m	£97.3m	+£15.7m
Net debt	£126.9m	£136.6m	+£9.7m
O/s debt to CFR (%)	102.3%	100.6%	-1.7%
Net debt to CFR (%)	54.1%	58.8%	+4.7%

(*) projected 31 March 2007

Advice received from the council's external advisors suggests that borrowing should be at or near the maximum permitted in order to reduce the risk that demand for capital investment (and hence resources) will fall in years of high interest rates. The above table shows that borrowing is consistent with this advice.

Cash flow debt / investments

The TMPS recommended "to maintain a short term debt and investment portfolio that is consistent with long term funding requirements and cash flow movement."

An analysis of the cash flows reveals a net shortfall for the 2nd half-year of £10.6m (Table 4). This total does not include 3 cash payments totalling £11.0m that were due in March 2007 but deferred until April:

- £3.2m interest payable on PWLB debt deferred until 2 April with the lenders agreement;
- £4.6m payment to creditors deferred until 3 April due to technical problems; and
- £3.2m receipt of social housing grant that was paid over to a housing association on 4 April.

If these 3 payments had been made in March then the cash shortfall in the 2nd half-year would have totalled £21.6m – a level similar to previous years.

Table 4 – Cash flow October 2005 to March 2006

	Payments	Receipts	Net cash
Total for period	£338.0m	£327.4m	-£10.6m
Decrease in long-term borrowing			-£6.0m
Net movement in short term position			***-£16.6m***

Taking into account the decrease in net long-term borrowing the total cash shortfall amounted to £16.6m for the 2nd half-year. After adjusting for the increase in the funds invested by the cash manager of £0.5m the net movement is reduced to £16.1m. The shortfall has been funded by reducing the level of investments (Chart 2, Appendix 3).

Overall the cash position for the year is a net surplus of £25.5m (or £14.5m taking into account the 3 deferred cash payments above).

There has been no short-term borrowing during the half-year. Cash flow receipts, together with accumulated investments, have exceeded cash flow requirements throughout the period, thereby negating the need to raise funds temporarily.

Prudential indicators

Full Council approved a series of prudential indicators for 2006/07 at its meeting in March 2006. Taken together the indicators demonstrate that the council's capital investment plans are affordable, prudent and sustainable. Full details are set out in appendix 4.

In terms of treasury management the main indicators are the 'authorised limit' and 'operational boundary'. The authorised limit is the maximum level of borrowing that can be outstanding at any one time. The limit is a statutory requirement as set out in the Local Government Act 2003. The limit includes 'headroom' for unexpected borrowing resulting from adverse cash flow.

The operational boundary represents the level of borrowing needed to meet the capital investment plans approved by the council. Effectively it is the authorised limit minus the headroom and is used as an in-year monitoring indicator to measure actual borrowing requirements against budgeted forecasts.

Table 5 compares both indicators with the maximum debt outstanding in the 2nd half-year.

Table 5 – Comparison of outstanding debt with Authorised Limit and Operational Boundary 2006/07

	Authorised limit	Operational boundary
Indicator set	£268m	£248m
Maximum amount o/s in second half of year	£239.9m	£239.9m
Variance	£28.1m(*)	£8.1m

(*) can not be less than zero

Performance

The series of charts in Appendix 3 provide a summary of the performance for both the debt and investment portfolios.

In summary the key performance is as follows:

- Chart 1 shows the average cost of the long-term debt portfolio remaining at 4.79%, a reduction from the 4.93% at the beginning of the year;
- Chart 2 shows the level of investment managed by the cash manager and the in-house treasury team. The sum invested by the cash manager increases as investment income is reinvested. The amount invested by the in-house treasury team is analysed between cash flow investments (that are invested to meet short-term cash commitments) and core investment (that have a longer investment profile to match the spending profile for both the revenue & capital investment programmes).
- Chart 3 compares the returns achieved on external investments with the benchmark rate of 7-day LIBID rate for the in-house treasury team and 7-day LIBID rate (compounded) for the cash manager. The chart confirms that the investment performance of:
  - the in-house treasury team has exceeded the benchmark rate (i.e. the base line) on both cash flow and core investments but is below the target rate (which is 105% of the benchmark rate). The return for the

year was 4.88% (cash flow) and 4.9% (core) against a benchmark rate of 4.83%.

- the investment performance of the cash manager has exceeded the benchmark rate but is below the target rate (also 105% of the benchmark rate). The return for the year was 5.1% against a benchmark rate of 4.98%.

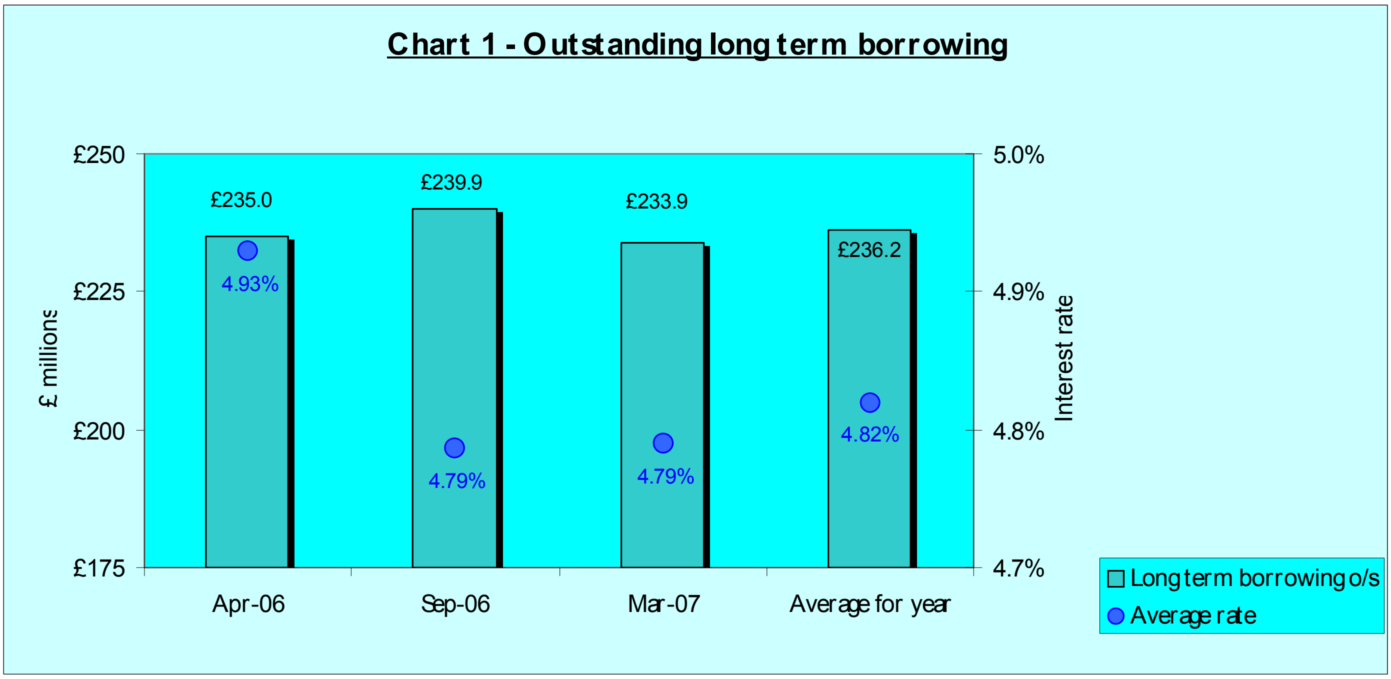
Approved organisations – investments

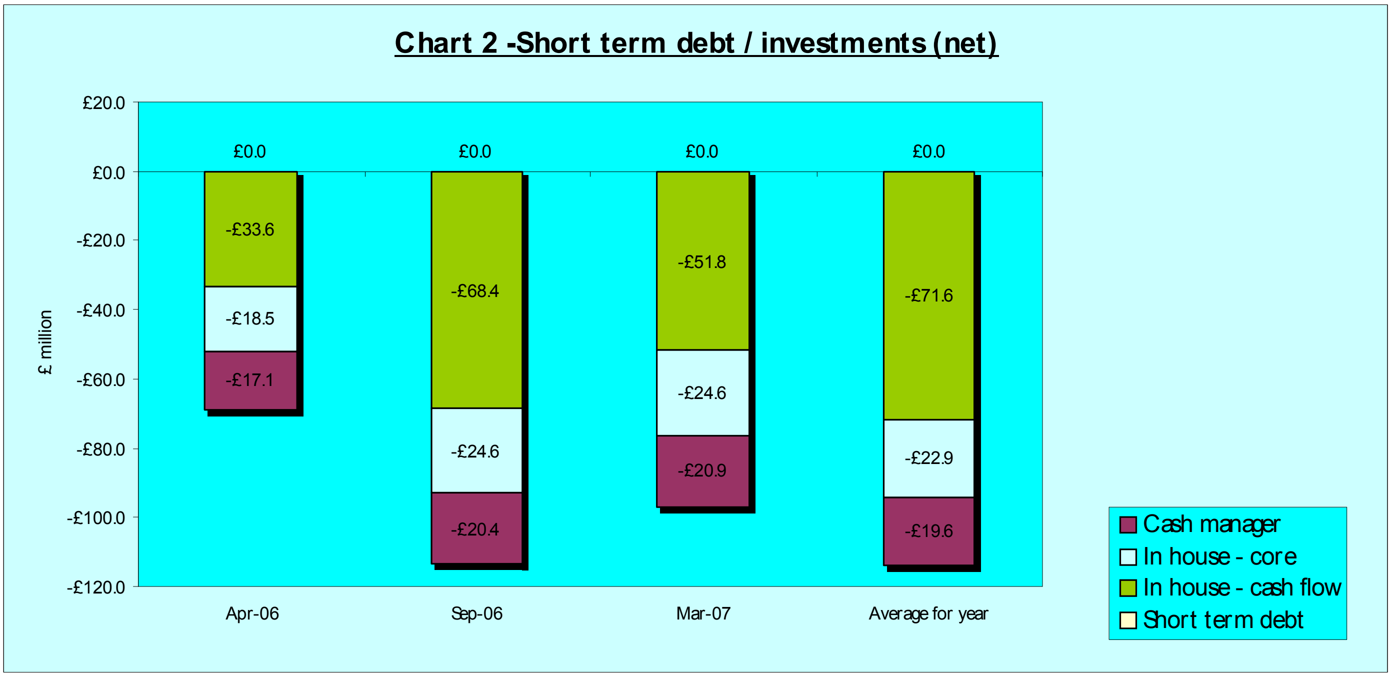
There were no breaches of the investment criteria during the second half-year.

Appendix 3

Treasury Management Policy Statement 2006 /2007
End of year review

Charts





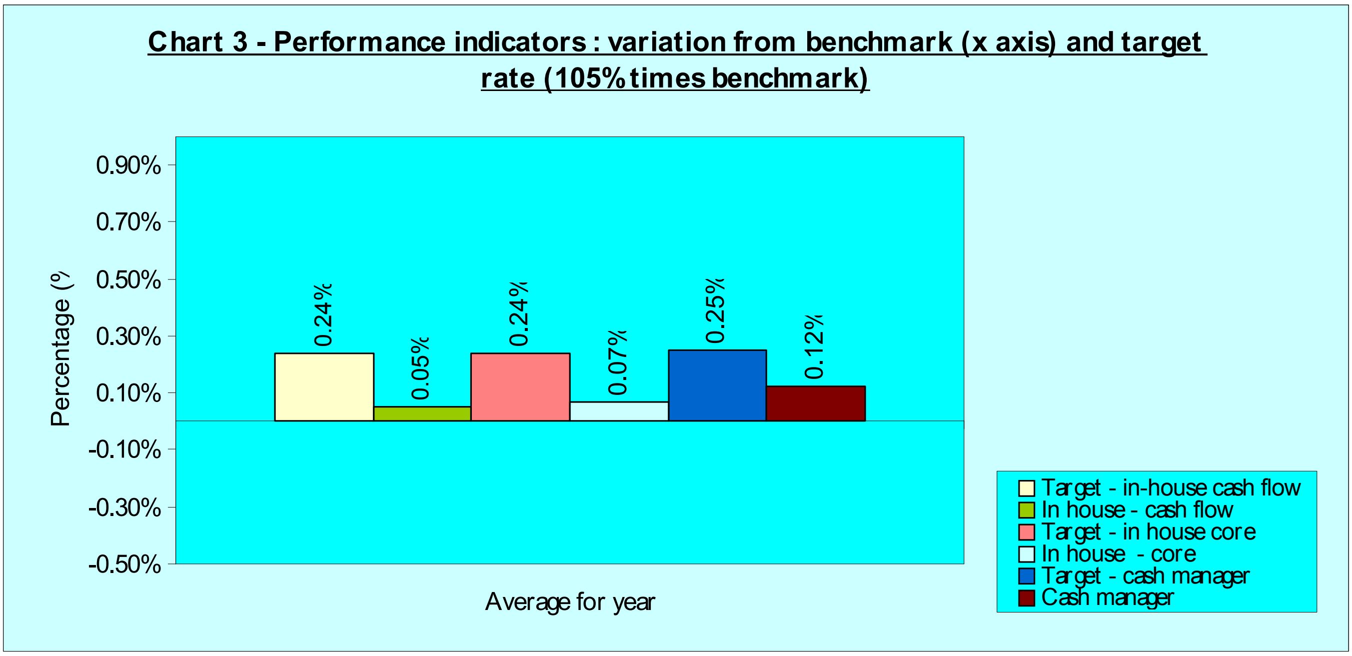
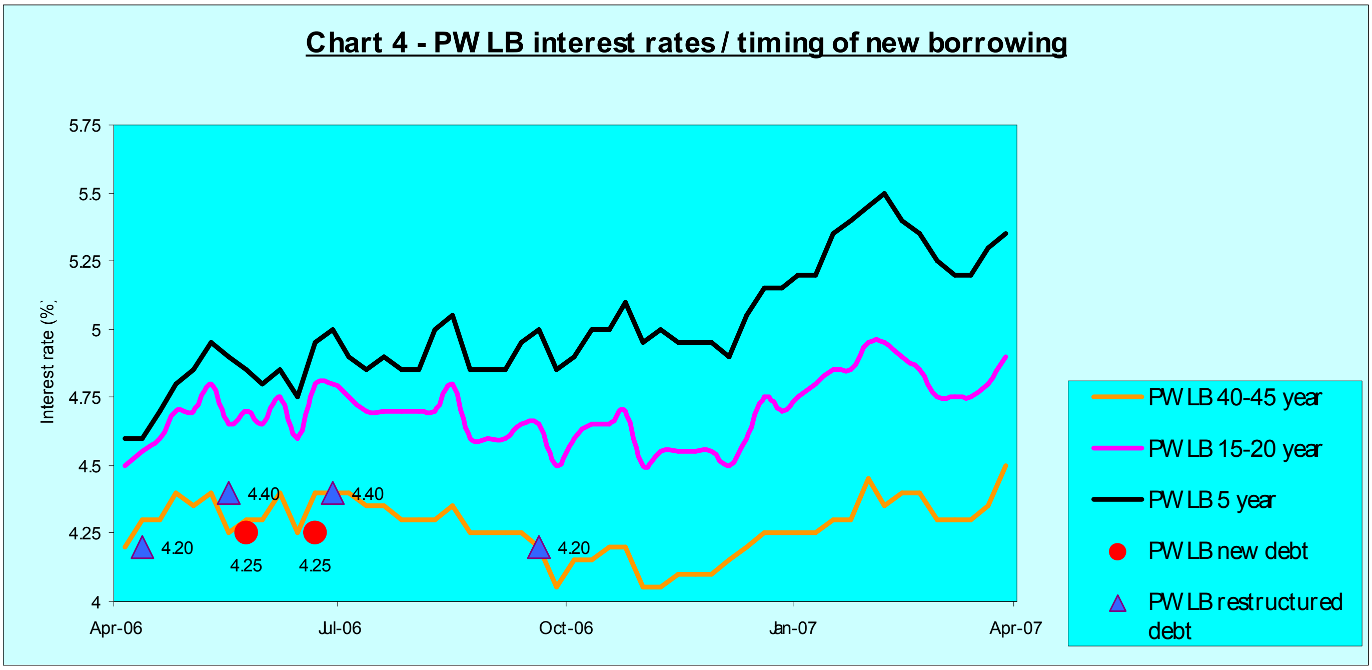


Chart 3 Note – The average rate of return for the cash manager includes increases / decreases in the capital value of investments purchased as well as interest accrued but not yet received..



Appendix 4

Prudential indicators 2006/07
Requirement to report 'Actuals' for year

The following prudential indicators are required to be reported under the Prudential Code for Capital Finance in Local Authorities (published by CIPFA).

Prudential indicator	Actual indicator 2006/07
Actual ratio of financing costs to net revenue stream 2006/07	
- Non HRA	3.29%
- HRA	35.03%
Actual capital financing requirement as at 31 March 2007	
- Non HRA	£143.515m
- HRA	£88.918m
- Total	£232.433m
Actual external debt as at 31 March 2007	
- Actual borrowing	£233.939m
- Actual other long term liabilities	£0.000m
- Total	£233.939m