CABINET MEETING	Agenda Item 113 Brighton & Hove City Council

Subject:		**Treasury Management Policy Statement 2008/09 (including Annual Investment Strategy 2008/09) – Mid Year Review**		
Date of Meeting:		**20 November 2008**		
Report of:		**Interim Director of Finance & Resources**		
Contact Officer:	**Name:**	**Peter Sargent** **Loans & Technical Manager**	**Tel:**	**29-1241**
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Key Decision:	**No**			
Wards Affected:	**All**			

FOR GENERAL RELEASE

1. SUMMARY AND POLICY CONTEXT:

1.1 The Treasury Management Policy Statement 2008/09 (TMPS) and the Treasury Management Practices (including the schedules) (TMPs) for the year commencing 1 April 2008 were approved by Policy & Resources Committee on 6 March 2008. Full Council approved the Annual Investment Strategy 2008/09 (AIS), which forms part of the TMPS, on 13 March 2008. The policy statement 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. The AIS sets out the parameters within which investments can be made.

1.2 The purpose of this report is to advise of the action taken during the period April to September 2008 to meet the policy statement and practices and the investment strategy.

2. RECOMMENDATIONS:

2.1 That the Cabinet:

a) endorse the action taken during the half-year to meet the TMPS and associated TMPs and the AIS;

b) endorse the action taken to tighten the investment parameters set out in the AIS as detailed in paragraph 3.3.3;

c) note the authorised limit and operational boundary set by the Council have not been exceeded;

d) earmark any surpluses generated on the Financing Costs budget in 2008/09 to contribute towards possible future shortfalls in the investment interest budget as a result of base rate cuts;

e) note the budgeted support from net investment income to the General Fund in 2008/09 is £4.1m, the equivalent to circa £45 in council tax on a Band D property; and

f) note the latest projection for investment income on all funds in 2008/09 is £7.7m of which £4.9m is for the General Fund.

3. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:

3.1 Overview of markets

3.1.1 The turmoil in the financial markets has been a dominant feature since the summer months of last year. In May 2008 the Bank of England concluded that financial markets remain under stress and these stresses have lasted longer and have been deeper and wider than many have been expecting. The central problem is that financial markets are currently dominated by “uncertainty” rather than “risk” and consequently markets remain fragile.

3.1.2 The main issue underlying the turmoil has been the unwillingness of banks and others to lend and take on credit risk. This has led to a higher market interest rates compared to official rates.

3.1.3 The economy is and remains in difficult and uncharted waters with policy makers facing a combination of pressures and dilemmas not experienced for several decades. As a result the economy is in a precarious position. The rise in imported energy and commodity prices inevitably has the effect of squeezing households’ real disposable income and spending power. Notwithstanding the slow-down in growth on both sides of the Atlantic, the three major central banks (US, UK and the Euro area) gave signals that no early cut in interest rates should be expected. This decision was reversed in early October as central banks throughout the World injected massive sums as rescue packages to support the financial sector.

3.1.4 A commentary on the markets looking ahead is set out in Appendix 1 to this report.

3.2 Treasury Management Strategy

3.2.1 A summary of the action taken in the six months to September 2008 is provided in Appendix 2 to this report. The main points are:

- long-term debt portfolio (which has been used to fund the capital investment programme in the City) has remained at £239.9m, with no new borrowing, repayments or restructuring in the period;
- the level of investments as at 30 September 2008 totalled £145.6m, an increase of £28.9m from the beginning of the year (for details see paragraph 3.2.2 below);
- the return on investments by the in-house treasury team and cash manager has exceeded the target rate;
- the two borrowing limits approved by Budget Council in February 2008 – the ‘authorised limit’ and ‘operational boundary’ – have not been exceeded in the first half of the year.

3.2.2 As part of the annual budget process the council has to determine the level of cash balance, reserves and provisions it requires in setting the council tax, housing rents and capital investment programmes. For the major part of the financial year these balances are supplemented by substantial cash flow surpluses resulting from timing differences between income and expenditure. The council has a duty to ensure these balances are invested for the purposes of the prudent management of its financial affairs. The table below summarises the balance available for investment.

	Cash balance, Reserves & Provisions	Cash flow	Total
Reserves to meet day to day risks – General Fund	£9.8m		£9.8m
Reserves to meet day to day risks – Housing Revenue Account	£5.7m		£5.7m
Reserves earmarked for future years' liabilities and obligations	£48.0m		£48.0m
Reserves earmarked for agreed capital investment	£22.1m	£5.0m	£27.1m
Net cash balance earmarked to meet known short-term liabilities		£26.1m	£26.1m
Amount invested 1 April 2008	£85.6m	£31.1m	£116.7m
Cash received exceeds cash payments April to September 2008			£28.9m
Amount invested 30 September 2008			£145.6m

3.2.3 Official interest rates, as set by the Bank of England, have remained relatively unchanged in the first 6 months in 2008/09. However market rates have continued to factor in the liquidity problems faced by many institutions. These elevated interest rates have, in part, contributed towards the higher than budgeted investment returns in 2008/09.

3.2.4 In October 2008 the Bank of England announced a 50 basis points (½%) cut in official rates. This cut is widely expected to be the first of a number of cuts over the next 18-months as the Bank switches its attention from inflation to negative economic growth. The general concensus of forecasts for the official Bank Base Rate by March 2010 is 3¼%, with the average for 2009/10 at circa 3.3-3.4%. Market rates are projected to follow a similar but more dramatic fall as the margin between official rates and market rates narrows. Market rates for 2009/10 are projected to average around 4%, some 200 basis points (2%) lower than the current financial year. Interest rates in 2010/11 are expected to be marginally above the average for 2009/10.

3.3 Investment Strategy

3.3.1 The review period has seen unprecedented turbulence in the financial markets. In late September the Government used the powers within the Banking (Special Provisions) Act 2008 to provide financial assistance to a High Street bank. In early October the Government implemented a comprehensive set of measures to help stabilise UK banks and building societies during the period of exceptional instability in the global financial markets. During this period officers have continuously reviewed the lending list of institutions responding as rapidly as possible to changes in the markets.

3.3.2 So far the impact on the council's investment strategy has been minimal. The risk parameters within the AIS are very tight, with investments only permitted in institutions of high credit worth. However the collapse of Icelandic banks in early October has led to a review of the strategy. The measures introduced by the Government should improve market stability but it is generally felt there will be a time delay before the effects are felt. An initial assessment suggests that improvement in liquidity is likely to happen first in the very short-end (i.e. periods out to one month).

3.3.3 With effect from 13 October 2008 the investment period for all new investments has been reduced to a maximum of one month. The selection of investment counterparty will be more intensive than present and will not be solely based on a satisfactory credit rating or asset base. For example new information gathered on the current or perceived financial position of a counterparty will determine whether investment will be made in that counterparty. A number of counterparties have been suspended from the council's lending list and will remain so, despite the assurances provided by the Government, as the future of these counterparties is presently unclear.

3.4 Security of investments

3.4.1 A summary of investments made by the in-house treasury team as at 16 October 2008 is tabled below.

Banks subject to HM Treasury support	£35.3m	23%
Banks subject to Irish Government guarantee	£28.5m	19%
Banks eligible for HM Treasury support	£17.0m	11%
Building societies eligible for HM Treasury support	£59.5m	40%
Money market funds	£11.2m	7%
TOTAL	£151.5m	100%

3.4.2 The above table shows the majority of investments are covered by the guarantees and financial support offered by the UK and Irish Governments. Money market funds offer a low risk but highly liquid (i.e. repayable on the day) investment opportunity through investment in a diverse range of high quality, short-term and negotiable instruments. By utilising these funds the council is able to benefit from the low risk environment whilst at the same time achieving a competitive return and, equally important, highly liquid investment resource.

4. CONSULTATION

4.1 The council's external treasury advisors have been consulted in the drafting of this report. No other consultation was necessary.

5. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

5.1 The financial implications arising from the action taken under the TMPS are included in the monthly projection for Financing Costs. The month 6 forecast for financing costs under the 'target budget management' initiative shows an underspend of £800,000.

5.2 The Medium Term Financial Strategy (MTFS) includes investment income for 2009/10 averaging around 5% and for 2010/11 around 5.2%, a full one percentage point above latest projections. The projected fall in interest rates will therefore have a substantial adverse impact on investment returns for these years (based on budgeted investment levels a 50 basis points (½%) fall in rates equates to approximately £600,000 reduction in investment income). Action will be taken, where possible, to minimise any adverse impact of lower interest rates in 2009/10 but the decision taken by officers in October 2008 to reduce new investments for one month may limit the scope for such action if the current uncertainty in the financial markets continues for any considerable period. The recommendation in this report is to earmark surpluses generated in 2008/09 to meet possible future shortfalls in investment interest will help limit the impact in 2009/10.

Finance Officer Consulted: Peter Sargent *Date: 20 October 2008*

Legal Implications:

5.2 Action under the TMPS 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: Abraham Ghebre-Ghiorghis *Date: 22 October 2008*

Equalities Implications:

5.3 There are no direct implications arising from this report.

Sustainability Implications:

5.4 There are no direct implications arising from this report.

Crime & Disorder Implications:

5.5 There are no direct implications arising from this report

Risk & Opportunity Management Implications:

5.6 The turmoil in the financial markets has led to an increase in the risk that investments will not be repaid. However the action taken by the Central Banks to support the banking industry and the action by the in-house treasury team to reduce investment periods are considered appropriate to mitigate this increased risk. Opportunities to benefit from higher levels of interest will be taken consistent with the new measures.

Corporate / Citywide Implications:

5.7 Investment income is used to support the budget requirement for the council. Any action taken to reduce the risk of capital loss will have a downward impact on the level of interest received.

6. EVALUATION OF ANY ALTERNATIVE OPTION(S):

6.1 This report sets out action taken in the six months to September 2008. No alternative options are therefore considered necessary.

7. REASONS FOR REPORT RECOMMENDATIONS

7.1 The TMPS requires the Director of Finance & Resources to report on the action taken by the council in meeting borrowing limits and investment parameters. This report fulfils that requirement.

SUPPORTING DOCUMENTATION

Appendices:

Appendix 1 – Expectations on the Economy and Interest Rate movements

Appendix 2 – A summary of the action taken in the period April to September 2008

Appendix 3 – Performance and balances

Documents In Members' Rooms

None

Background Documents

Part I of the Local Government Act 2003 and associated regulations

The Treasury Management Policy Statement and associated schedules 2008/09 approved by Policy & Resources Committee on 6 March 2008

The Annual Investment Strategy 2008/09 approved by full Council on 13 March 2008

Papers held within Strategic Finance, Finance & Resources

The Prudential Code for Capital Finance in Local Authorities published by CIPFA 2003