

<b>Audit Committee</b>		<b>Agenda Item:</b>
<b>Meeting Date</b>	<b>19 September 2011</b>	
<b>Report Title</b>	<b>Annual Treasury Management Report 2010-11</b>	
<b>Portfolio Holder</b>	<b>Cllr Duncan Dewar-Whalley , Cabinet Member for Finance and Performance</b>	
<b>SMT Lead</b>	<b>Nick Vickers, Head of Finance</b>	
<b>Head of Service</b>	<b>Nick Vickers, Head of Finance</b>	
<b>Lead Officer</b>	<b>Deborah Walton, Senior Accountant</b>	
<b>Key Decision</b>	<b>No</b>	
<b>Classification</b>	<b>Open</b>	
<b>Forward Plan</b>	<b>Reference number</b>	

<b>Recommendations</b>	1. To approve the actual 2010-11 prudential indicators within the report.
	2. To approve the Treasury Management stewardship report for 2010-11.

## **1 Purpose of Report and Executive Summary**

- 1.1 The CIPFA definition of Treasury Management is “the management of the Council’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”.
- 1.2 The Treasury Management Code requires local authorities to determine an annual Treasury Management Strategy and now, as a minimum, formally report on their treasury activities and arrangements to Members mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities, and to enable those with ultimate responsibility for the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives. When this report is agreed by this Committee it will then go forward to Cabinet and full Council.
- 1.3 The Council has complied with all of the relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities.

## 2 Background

### Economic Background

- 2.1 At the time of determining the strategy for 2010-11, interest rates were expected to remain low in response to the fragile state of the UK economy. Spending cuts and tax increases seemed inevitable post the General Election if the government had a clear majority. The markets had, at the time, viewed a hung parliament as potentially disruptive particularly if combined with a failure to articulate a credible plan to bring down government borrowing. The outlook for growth was uncertain due to consumers and corporates trimming their spending and financial institutions exercising restraint in new lending.
- 2.2 The economy's two headline indicators moved in opposite directions – growth was lacklustre whilst inflation spiked sharply higher. The economy grew by just 1.3% in calendar year 2010; and the forecast for 2011 was revised down to 1.7% by the Office of Budget Responsibility in March. Higher commodity, energy and food prices and the increase in VAT to 20% pushed the February 2011 annual inflation figure to 4.4%. The Bank Rate was held at 0.5% as the economy grappled with uneven growth and the austerity measures set out in the coalition government's Comprehensive Spending Review.
- 2.3 During the year money market rates increased marginally at the shorter end (overnight to 3 months). 6 -12 month rates increased between, 0.25% to 0.3% over the 12 month period reflecting the expectation that the Bank Rate would be raised later in 2011. Relevant interest rate indices are attached in Appendix I.

### Borrowing Requirement and Debt Management

- 2.4 The overall borrowing position is summarised below:

	Balance on 31/3/2010 £'000	New Borrowing £'000	Debt Maturing £'000	Balance on 31/3/2011 £'000	Average Rate %	Average Life (days)
Capital Financing Requirement	8,884			8,044		
Short Term Borrowing	0	2,000	(2,000)	0	0.35	15
Long Term Borrowing	0	0	0	0		
<b>TOTAL EXTERNAL BORROWING</b>	<b>0</b>			<b>0</b>		
Other Long Term Liabilities	3,179			2,526		
<b>TOTAL EXTERNAL DEBT</b>	<b>3,179</b>			<b>2,526</b>		
Increase/(Decrease) in External Borrowing				0		

- 2.5 The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31 March 2011 was estimated at £8.1m. The Council's borrowing requirement during the year was £2m, and this was

undertaken short term due to fluctuations in cashflow. The Council's policy remains not to borrow to fund capital expenditure.

### Investment Activity

- 2.6 The Council held average cash daily balances of £7.0m during the year. These represented working cash balances / capital receipts, and the Council's reserves.
- 2.7 The Communities and Local Government's (CLG) Guidance on Investments, revised during 2009-10, reiterated security and liquidity as the primary objectives of a prudent investment policy. Although the Guidance became operative on 1 April 2010, its principal recommendations run parallel to the credit risk management requirements in the revised Treasury Management Code. In the revised Guidance, Specified Investments are those made with a body or scheme of "high credit quality". Both the Guidance and the revised Treasury Management Code emphasise that counterparty credit criteria should not rely on credit ratings alone but should include a wider range of indicators. The revised Code nonetheless requires that ratings assigned by all three rating agencies – Fitch, Moody's and Standard & Poor's – be taken into account and the lowest rating be used.
- 2.8 The criteria applied by the Head of Finance for the approval of a counterparty are:
- A strong likelihood of Government intervention in the event of liquidity issues based on systematic importance to the UK economy (for individual financial institutions);
  - Credit rating (Council's minimum long term counterparty rating of A+ across all 3 rating agencies, Fitch, Standard & poor's and Moody's;
  - Credit default swaps;
  - Share price;
  - Reputational issues;
  - Exposure to other parts of the same banking group;
  - Country exposure.
- 2.9 The Council only makes Specified Investments ie, deposits with a duration that does not exceed 364 days and there is no facility for making Non-Specified Investments ie, with a duration of over 364 days. This reflects both the continuing lack of stability in financial markets and the need to keep the duration of funds short for cashflow purposes.

2.10 The specified investments permissible are:

<b>Specified Investment Instrument – (in sterling)</b>	<b>Limits and Maturity dates</b>
Term deposits with :- Government backed deposits <ul style="list-style-type: none"> <li>• The UK government</li> <li>• Gilt Edged Securities</li> </ul>	Unlimited amount and maximum maturity up to 364 days  Unlimited amount and maximum maturity up to 364 days
Local authority deposits <ul style="list-style-type: none"> <li>• UK local authorities</li> </ul>	Unlimited amount and maximum maturity up to 364 days
Banking deposits <ul style="list-style-type: none"> <li>• Money Market Funds</li> </ul>	£2m limit for AAmmf rated funds as defined by Fitch and/or equivalent ratings by Moody's and Standard & Poor's (funds held on call)
<ul style="list-style-type: none"> <li>• UK Banks and building societies</li> </ul>	£2m limit for F1 / minimum A+ rated institutions as defined by Fitch and/or equivalent ratings by Moody's and Standard & Poor's for a maximum period of 364 days with a minimum stable short and long term rating watch
Bonds Bonds issued by multilateral development banks (European Investment Bank / Council of Europe)	£2m limit and maturity up to 364 days

2.11 The UK financial institutions used were;

Bank of Scotland Plc  
 Lloyds TSB Bank Plc  
 Barclays Bank Plc  
 Clydesdale Bank  
 HSBC Bank Plc  
 Royal Bank of Scotland Plc  
 National Westminster Bank  
 Standard Chartered Bank  
 Santander UK Plc  
 Nationwide Building Society

Santander UK Plc has been suspended since November 2010 due to underlying issues arising from its' Spanish ownership and Clydesdale Bank has been suspended since February 2011 due to Moody's credit rating agency placing the bank on review for a possible downgrade.

Standard Chartered Bank and National Westminster Bank were added in February 2011 as approved by Council on 23 February 2011.

2.13 The deposits for the year are summarised below:

<b>Investments</b>	Balance on 31/3/2010 £'000	Investments Made £'000	Maturities £'000	Balance on 31/03/2011 £'000	Average Rate %	Average Life (days)
Short Term Investments	724	142,863	(141,677)	1,910	0.73	24
Long Term Investments	8	0	0	8	3.34	Undated
<b>TOTAL INVESTMENTS</b>	732			1,918		
Increase/ (Decrease) in Investments £m				1,186		

2.14 Liquidity - In keeping with the CLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds / overnight deposits / the use of call accounts.

2.15 Yield - The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates remained at very low levels (as shown in Appendix I) which has a significant impact on investment income.

The Council's budgeted investment income for the year has been estimated at £75,000 and actual income received was £53,000.

2.16 The Council has a very cautious treasury policy – we need at all costs to preserve our principal sums even in a rising inflation period where the real value of the funds is being eroded.

2.17 The Council subscribes to the CIPFA Treasury Management Benchmarking and we receive quarterly benchmarking from Arlingclose. This will be explained further at the treasury management training session which is being arranged for the Committee.

#### Compliance with Prudential Indicators

2.18 The Council has complied with its Prudential Indicators for 2010-11 which were set as part of the Treasury Management Strategy agreed by Council on 24 February 2010, with a further amendment agreed by Council on 1 December 2010.

2.19 In Appendix II the outturn position for the year against each Prudential Indicator is set out.

## Treasury Management Practices

2.20 A full of review The Council's Treasury Management Practices (TMP's) as required under the CIPFA Code was completed over the end of the financial year 2010-11 and approved by Audit Committee on 20 June 2011.

## Treasury Advisers

2.21 Arlingclose has been the Council's treasury advisers since May 2009. Officers of the Council meet with them regularly and high quality and timely information is received from them.

## **3. Proposal**

3.1 Members are asked to approve the report.

## **4. Alternative Proposals**

4.1 No alternative proposals have been considered and compliance with the CIPFA Code is mandatory.

## **5. Consultation Undertaken**

5.1 Arlingclose have been consulted.

## **6. Implications**

<b>Issue</b>	<b>Implications</b>
Corporate Plan	Supports the objective of Becoming a High Performing Council.
Financial, Resource and Property	The Council's Treasury Strategy is agreed annually as part of the budget process.
Legal and Statutory	Need to comply with CLG guidance on treasury management.
Crime and Disorder	No application
Risk Management and Health and Safety	No application
Equality and Diversity	No application
Sustainability	No application

## **7. Appendices**

- 7.1 Appendix I: Interest Rates for 2010-11  
Appendix II: Prudential Indicators for 2010-11

## **8. Background Papers**

- 8.1 Treasury Strategy report, Council, 23 February 2010.
- 8.2 Quarterly Treasury Management Report for Quarter 1 2010-11, Cabinet, 25 August 2010.
- 8.3 Mid Year Treasury Management Report for 2010-11, Council, 1 December 2010.
- 8.4 Treasury Management Practices, Audit Committee, 20 June 2011.

Interest Rates for 2010-11

Interest Rates %							
End Qtr	Bank Rate	London Inter Bank Bid Rate (LIBID)			Public Works Loan Board Rates (PWLB)		
		7 Day	6 Month	1 Year	5 Year	20 Year	50 Year
Mar 2010	0.50	0.25	0.81	1.26	2.89	4.65	4.69
Jun 2010	0.50	0.35	0.94	1.38	2.27	3.62	4.27
Sep 2010	0.50	0.25	1.01	1.46	1.88	3.86	4.02
Dec 2010	0.50	0.40	1.01	1.47	3.33	5.18	5.16
Mar 2011	0.50	0.50	1.11	1.58	3.57	5.27	5.24



Prudential Indicators for 2010-11**Table 1 – Actual Capital Expenditure Financing**

	<b>2010-11 Actual £000</b>	<b>2010-11 Original Estimate £000</b>	<b>2009-10 Actual £000</b>
<b>Total General Fund capital expenditure</b>	<b>4,469</b>	<b>4,893</b>	<b>5,351</b>
Resourced by:			
Capital receipts	(294)	0	(1,005)
Capital grants	(3,613)	(3,799)	(3,855)
Minimum Revenue Provision	(840)	(815)	(845)
Capital financed from revenue	(562)	(1,094)	(92)
<b>Increase / (Reduction) in underlying need to borrow</b>	<b>(840)</b>	<b>(815)</b>	<b>(446)</b>

**Table 2 – Actual Capital Financing Requirement**

<b>Capital Financing Requirement (CFR)</b>	<b>31 March 2011 Actual £000</b>	<b>31 March 2011 Original Estimate £000</b>	<b>31 March 2010 Actual £000</b>
Opening balance	8,884	8,884	9,330
Increase / (Reduction) in underlying need to borrow (unsupported by governmental financial assistance)	(840)	(815)	(446)
<b>Closing balance</b>	<b>8,044</b>	<b>8,069</b>	<b>8,884</b>

**Table 3 - Net Borrowing and the Capital Financing Requirement**

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 local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

The Interim Head of Finance reports, that the authority had no difficulty meeting this requirement in 2010-11, 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.

**Net borrowing position against the CFR**

	<b>31 March 2013 Original Indicator £'000</b>	<b>31 March 2012 Original Indicator £'000</b>	<b>31 March 2011 Actual £'000</b>	<b>31 March 2011 Original Indicator £'000</b>	<b>31 March 2010 Actual £'000</b>
Net borrowing position	0	0	0	0	0
CFR	6,586	7,495	8,044	8,069	8,884

**Table 4 – Authorised Limit / Operational Boundary / Actual External Debt and Financing Ratio**

	<b>2010-11</b>
<b>Original Indicator - Authorised Limit</b>	<b>£7.0m</b>
Actual Borrowing	£0m
Actual Other Long Term Liabilities	£2.526m
<b>Actual External Debt at 31 March 2011</b>	<b>£2.526m</b>
<b>Original Indicator - Operational Boundary</b>	<b>£5.825m</b>
Actual Borrowing	£0m
Actual Other Long Term Liabilities	£2.526m
<b>Actual External Debt at 31 March 2011</b>	<b>£2.526m</b>
Financing costs as a proportion of net revenue stream	4.13%

**Table 5 - Resources**

<b>Balance Sheet Resources</b>	<b>31 March 2011 £000</b>	<b>31 March 2010 £000</b>
Revenue Balances	3,134	2,559
Earmarked reserves	7,255	6,643
Usable capital receipts	708	773
Capital Grants Unapplied	412	341
<b>Total</b>	<b>11,509</b>	<b>10,316</b>

**Table 6 – Upper Limits for Interest Rate Exposure**

	<b>Upper Limit %</b>	<b>Actual Average 2010-11</b>
Fixed Rate exposure	100	32
Variable Rate exposure	100	68

**Table 7 – Investment Benchmarking**

<b>Average Actual Return on Investments</b>	<b>Original Estimate Return on Investments</b>	<b>Average Bank Rate</b>	<b>Average 7 day LIBID Rate</b>
0.73%	0.70%	0.50%	0.43%

**Table 8 – Borrowing Maturity Structure**

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

<b>Maturity structure of fixed rate borrowing during 2010-11</b>	<b>Upper Limit</b>	<b>Lower Limit</b>
under 12 months	100%	0%
12 months and within 24 months	0%	0%
24 months and within 5 years	0%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%

The Council borrowed on a temporary basis in April 2010 for a period of two weeks to cover cash-flow pressures. The maximum amount borrowed was £2 million.

## **Adoption of the CIPFA Treasury Management Code**

This indicator demonstrates that the Council has adopted the principles of best practice.

The Council approved the adoption of the CIPFA Treasury Management Code on 26 June 2002 by the Executive and adopted by Council on 24 July 2002.

The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices as detailed in the Treasury Management Strategy Statement and Investment Strategy 2010-11 approved by Council 24 February 2010.