Appendix 1

THE CABINET

12 JULY 2011

REPORT OF THE CABINET MEMBER FOR FINANCE, REVENUES AND BENEFITS

Title: Treasury Management Annual Report 2010/11	**For Decision**

Summary:

Recent changes in the regulatory environment now place a greater onus on Elected Members for the review and scrutiny of treasury management policy and activities. This report (The Treasury Management Annual Report) is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by the Assembly.

This report presents the Council's outturn position in respect of its treasury management activities during 2010/11 financial year. The key points to note are as follows:

- Investment income for the year was £1.4m;
- There was no borrowing in 2010/11 to finance the capital programme as, in line with part of the 2010/11 original treasury management strategy, the Council relied on internal borrowing; and
- The Council did not breech its 2010/11 authorised borrowing limit of £200m and also complied with other set treasury and prudential limits.

Wards Affected: This is a regular annual report of the Council's treasury management position and applies to all wards.

Recommendation(s)

The Cabinet is asked to recommend that the Assembly:

a) Note the Treasury Management Annual Report for 2010/11;

b) Note that the Council complied with all 2010/11 treasury management indicators;

c) Approve the actual 2010/11 prudential and treasury indicators in this report;

d) Note that the Council did not borrow in 2010/11 to finance its capital programme but utilised internal cash in line with its strategy; and

e) With regards the Housing Revenue Account Reform - agree in principle that the Council can borrow in advance of need for the Housing Revenue Account Reform should market opportunities become available and DCLG provides directive before 1 April 2012. Such a move by the Council will be after careful evaluation by the Corporate Director of Finance & Resources in conjunction with the Council's treasury management advisers. It is anticipated that the authorised limit will be in the region of £281m.

f) Agree in principle that the Council can raise finance for the HRA reforms using any or a combination of the following instruments – corporate bonds, public bonds,

bonds via a pooled Issuance vehicle, bank debt for example vanilla type loans or LOBO and Public Works Loan Board debt.
Reason(s) This report is required to be presented to the Assembly in accordance with the Revised CIPFA Code of Practice for Treasury Management in the Public Services.
Implications: **Financial:** This report sets out the outturn position on the Council's treasury management position and is concerned with the returns on the Council's investments as well as its short and long term borrowing positions. **Legal:** No comments to add. **Risk Management:** The whole report concerns itself with the management of risks relating to the Council's cash flow. The report mostly contains information on how the Treasury Management Strategy has been used to maximise income throughout the past year. **Social Inclusion and Diversity:** No specific implications. **Crime and Disorder:** No specific implications. **Options Appraisal:** Insofar as this report is concerned an options appraisal is not required.

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1. Purpose of Report

1.1. The Council is required through regulations issued under the Local Government Act 2003 (as amended 2010) to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2010/11.

This report also reviews the external cash portfolio managers for the financial year. The report has been produced in accordance with the Revised CIPFA Code of practice for Treasury Management in the Public Services 2009 adopted by this

Council on 16 February 2010 and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.2 This Annual Treasury Report covers:

- The Council's treasury position as at 31 March 2011;
- Annual Strategy Statement 2010/11;
- Economic Factors in 2010/11;
- Performance Management in 2010/11;
- Borrowing Outturn;
- Treasury Management costs in 2010/11;
- Compliance with treasury limits and treasury indicators; and
- Lending to Commercial and External Organisations
- HRA Reform

2. Treasury Position as at 31 March 2011

2.1 The Council's debt and investment position at the beginning and end of the financial year was as follows;

	31 March 2011 Principal £'000	Rate /Return	Average Life (yrs)	31 March 2010 Principal £'000	Rate/ Return	Average Life (yrs)
Fixed Rate Funding:						
PWLB	30,000	4.057%	3.18	30,000	4.057%	3.18
Variable Rate Funding:						
PWLB	0	0	0	0	0	0
Market	40,000	2.365%	57.52	40,000	2.240%	58.55
Total Debt	**70,000**	**3.090%**	**34.23**	**70,000**	**3.019%**	**34.82**
Investments						
In-House	38,790	1.66%		53,172	3.52%	
External Managers:						
Investec	28,292	1.18%		28,007	1.38%	
SWIP	11,432	1.19%		18,785	3.48%	
RBS	15,000	0.72%		15,000	2.86%	
Total Investments	**93,514**	**1.33%**		**114,964**	**2.69%**	

3. Annual Strategy Statement 2010/11

3.1 The Assembly endorsed the annual strategy for 2010/11 on the 24 February 2010.

3.2 The key points from that strategy were:

- To set an authorised borrowing limit of £200m;
- After careful consideration of rate forecast that the Council's in-house team and external investment managers would perform against a benchmark of

the higher of 1.5%, or the “3 Month LIBID rate” was set. This ensured that we provided sufficient challenge to our external fund managers;

- That the Council and its fund managers will have regard to the Council’s investment priorities being:
  - (a) The security of capital; and
  - (b) The liquidity of its investments
- That the Council and its fund managers adhere to the procedures set for use of different classes of asset (specified and non-specified) and the maximum periods which funds can be committed;
- That the Council and its fund managers adhere to its counterparty limits;
- The Council would operate both borrowing and investment portfolios at short and long term periods and as a consequence reduces the risk of being impacted by a sharp unexpected rise in short-term variable interest rates; and
- That the Council maintain a balance of funding at shorter-term rates to match short-term investments thus maintaining balanced treasury risk.

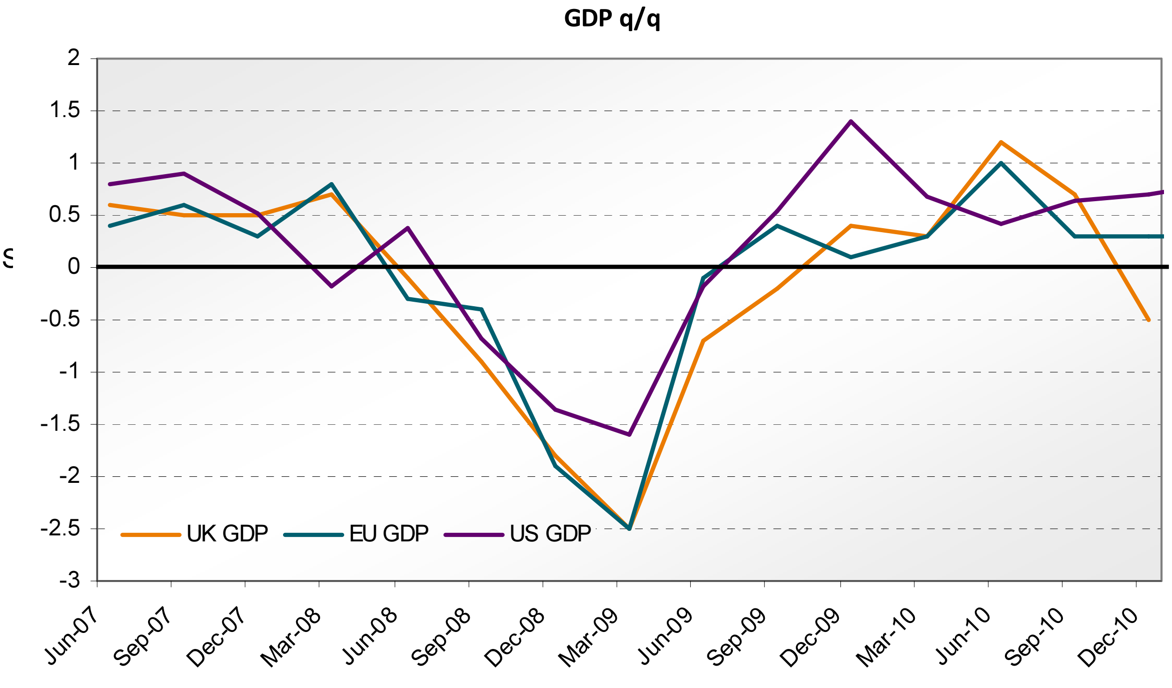
4. Economic Factors in 2010/11

4.1 The focus in 2010/11 was on sovereign debt issues rather than individual institutions. Local authorities were also presented with changed circumstances following the unexpected change of policy on Public Works Loan Board (PWLB) lending arrangements in October 2010. This resulted in an increase in new borrowing rates of 0.75 – 0.85%, without an associated increase in early redemption rates. This made new borrowing more expensive and repayment relatively less attractive.

4.2 UK growth proved mixed over the year. The first half of the year saw the economy outperform expectations, although the economy slipped into negative territory in the final quarter of 2010 due to weather conditions.

4.3 Gilt yields fell for much of the first half of the year as financial markets drew considerable reassurance from the Government’s debt reduction plans, especially in the light of Euro zone sovereign debt concerns

The table below shows GDP.



5.

5.1 Investment Policy

The Council's investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Assembly on 24 February 2010. The policy sets out the Council's approach for choosing investment counterparties.

5.2 Economic Issues Which Directly Impacted Treasury Management Performance

The major issue for treasury management in 2010/11 continues to be the huge difference between investment rates and borrowing rates which emerged during the recession due to the unprecedented fall in Bank Rate.
A further strong theme has been the major emphasis on mitigating risk by giving heightened preference to security and liquidity at a time when the world banking system was still under stress. In addition the issue of new CIPFA and statutory guidance on investing has meant that more of our investment portfolio is invested in instruments and counterparties which may sometimes have lower rates of return but **higher security and liquidity**. This has compounded the significant fall in total investment earnings compared to previous years.

5.3 Overall Performance

The Council earned £1.4millon gross of fees in interest from its investments in 2010/11. This represented performance of 1.33% against a benchmark of 1.50%. This performance is against a back drop of 3 Month LIBID uncompounded rate of 0.615% and 7 day LIBID uncompounded rate of 0.433%.

5.3.1 Specific Performance

A proportion of the Council's cash is managed by cash managers – Scottish Widows and Investec, This is to provide diversification and reduce the risk in concentrating all of its investments in a few counterparties thereby ensuring security of capital. Unlike fixed deposits which the internal team trades in, most instruments used the cash managers can be traded at short notice thereby ensuring that the Council can maintain liquidity of its funds at short notice.

- **In–House Team**
  The rate of return for the year was 1.66%. Performance was improved by investments fixed for long periods when interest rates were at around 6.0%. These matured in October 2010.

- **Investec**
  The rate of return for the year was 1.17%. Performance in 2010/11 was adversely affected by consistent low interest rates through out the year.

- **Scottish Widows Investment Partnership (SWIP)**
  SWIP's rate of return in 2010/11 was 1.19%.

5.3.2 Investment Funds Available

The level of investments available to the Council on the 1st April 2010 was £114.9m. This figure was made up of a range of balances including, revenue reserves and general operational cash balances. The amount available for investment will vary throughout the financial year depending on:

- Use of investment funds ;
- Profile for the receipt of grants;
- Temporary use of internal cash to fund new capital projects rather than borrowing at periods of high borrowing interest rates; and
- Cash flow management.

At 31 March 2011 the level of investments had decreased to £93.5m. This position was anticipated through the regular monitoring and projections of cash flow movement and was in line with projections at the beginning of the year.

5.4 Management of Investment Funds

5.4.1 The Council's investments are managed by four sources being:

- Council In House Team including investments with Royal Bank of Scotland;
- Scottish Widows Investment Partnership Limited; and
- Investec Asset Management Limited.

The Council meets periodically with its two external investment managers as well as with its Investment Adviser to discuss financial performance, objectives and targets in relation to the investments and borrowing managed on behalf of the Council

5.4.2 Internally, the Council manages a proportion of its investments in-house. This is invested with institutions of high credit standing listed in the Council's approved lending list and specified limits. The Council invests for a range of periods from overnight to 30 days and one year and in some cases over one year dependent on the Council's cash flows, its treasury management adviser's view, its interest rate view and the interest rates on offer.

6. Borrowing Outturn

6.1 Debt Performance

As highlighted in section 2 above the average debt portfolio interest rate remained unchanged over the course of the year. The approach during the year was to use cash balances to finance new capital expenditure so as to run down cash balances and minimise counterparty risk incurred on investments. This also maximised treasury management budget savings as investments rates were much lower than most new borrowing rates. This strategy is expected to change in 2011/12 due to borrowing rates on the rise.

6.2 Debt Rescheduling and New Borrowing

Debt rescheduling opportunities have been limited in the current economic climate and consequent structure of interest rates following increases in PWLB new borrowing rates in October 2010. There was no debt rescheduling in 2010/11.

As investment rates continue to remain at an all time low, the council considered short term savings it could make by internally financing new capital expenditure using existing cash balances which are only earning minimal rates of interest due to the fact that Bank Rate was kept at 0.5% all year. Using cash balances also meant reduced counterparty risk on the investment portfolio consequently no new borrowing took place in 2010/11.

7. Treasury Management Costs

7.1 The costs associated with the Treasury Management function comprises of a recharge of a proportion of the internal team's salary and senior officers salary, treasury management advisers fees and external managers fees.

The table below shows the treasury management costs for 2010/11

Salary Recharge	68,690
Treasury Management Software and other costs	6,465
Sector Treasury Limited	18,000
Investec Asset Management	33,606
Scottish Widows	24,178
	150,939

8. Compliance with Treasury and Prudential Limits

8.1 It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordable limits) are included in the approved Treasury Management Strategy

8.2 During the financial year to date the Council has operated within and complied with the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The Council's prudential indicators are set out in Appendix A to this report. In 2010/11, the Council did not bridge its authorised limit on borrowing of £200m. Operational limit set at the start of the financial year was £115m. However the final position was £147m.

9. Lending to commercial and external organisations

9.1 As part of our mitigation of risk strategies around delivering and continued value for money services with external organisations, the council should from time to time have the ability to make loans to external organisations.

9.2 Section 2 of the Local Government Act 2000 (power of well-being) gives authorities the power to lend as part of promotion or improvement of economic /social wellbeing of the Borough. The guidance encourages local authorities to use the well-being power as the power of first resort removing the need to look for powers in other legislation. Further the power provides a strong basis on which to deliver many of the priorities identified by local communities and embodies in community strategies. The Corporate Director of Finance & Resources determines the rates and terms of such loans.

10. Housing Revenue Account Reform

10.1 2010/11 saw the start of the abolition of the Housing Revenue Subsidy System in England and the introduction of the Housing Revenue Account Reform. Key factors are as follows:

- Limit on housing borrowing for each Council
- Borrowing must be affordable nationally as well as locally
- The new method is anticipated to be more generously funded

Although a Housing initiative, treasury management is impacted considerably because of the borrowing implications for the Council. Council's are therefore expected to have a suitable borrowing strategy in place before the final self-financing determinations is issued by DCLG in January 2012. It is expected that self- financing will commence in April 2012.

10.2 Should market opportunities become available which will facilitate borrowing at favourable rates, the Council may borrow in advance of need after careful consideration by the Corporate Director of Finance & Resources, legislation facilitating this from CLG and advice from its treasury management advisers. Based on current data it is anticipated that the authorised limit for the HRA will be around £281m, though this is subject to further clarification due to the Council's Estate Renewal programme.

10.3 The Council is currently working on the suitability which of the borrowing instruments available which could be used as a source of financing the repayment to DCLG on 1st April 2012. These include Public Works Loan Board (PWLB), Bank debt – Lenders option Borrowers Option (LOBO), Short term bank debt to assist with any transition periods it may require, Public Bonds, Private Placements and Pooled Issuance with other local authorities coming together to issue bonds under a pooled vehicle.

10.4 Assuming that the localism Bill receives Royal Assent later this year. In determining the suitability of which instrument to use, the Corporate Director of Finance & Resources will take advice from the Council's treasury adviser, banks and legal team on issues like when to access the market, how to structure the debt, overall portfolio and appropriate balance in terms of maturities, views on the direction of interest rates and risk management solutions.

11. Conclusions

11.1 The key conclusions to draw from this report are as follows:

a) That the Council complied with prudential and treasury indicators in 2010/11 financial year;
b) That the value of investments as at 31 March 2011 totalled £93.5million; and
c) That value of long term borrowing as at 31 March 2011 totalled £70m. This comprised both market and Public Works Loans Board (PWLB) loans and remained unchanged from 2010.

Appendix 1

Background Papers

- Assembly Report 24 February 2010 - Treasury Management Annual Strategy Statement 2010/11
- Revised CIPFA Code of Practice for Treasury Management in the Public Services 2009
- Sector Treasury Management Update. Quarter ended 31 March 2011.