

THE ASSEMBLY

11 July 2012

Title: TREASURY MANAGEMENT ANNUAL REPORT 2011/12	
Report of: THE CABINET MEMBER FOR FINANCE AND EDUCATION	
Open	For Decision
Wards Affected: All	Key Decision: Yes
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Accountable Divisional Director: Jonathan Bunt, Divisional Director of Finance and Resources	
Accountable Director: Tracie Evans, Corporate Director of Finance and Resources	
Summary: <p>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.</p> <p>This report presents the Council's outturn position in respect of its treasury management activities during 2011/12 financial year. The key points to note are as follows:</p> <ul style="list-style-type: none">➤ Investment income for the year was £1.2m;➤ There was no General Fund borrowing in 2011/12 to finance the capital programme as, in line with part of the 2011/12 treasury management strategy, the Council relied on internal borrowing;➤ £265.9m of external borrowing was required as part of the Housing Revenue Account ("HRA") self-financing settlement;➤ The Council breached the maturity structure for borrowing maturity of fixed rate borrowing as a result of taking advantage of low interest rates available for the HRA self-financing settlement;➤ The Council did not breach its revised 2011/12 authorised borrowing limit of £465m and complied with all other set treasury and prudential limits.	
Recommendation(s)	
That the Assembly: a) Approve the actual 2011/12 prudential and treasury indicators in this report; b) Approve the increase in maturity structure of fixed rate borrowing from 60% to	

100%;

- c) Note the Treasury Management Annual Report for 2011/12;
- d) Note that the Council complied with all 2011/12 treasury management indicators with the exception of the maturity structure for borrowing maturity of fixed rate borrowing;
- e) Note the £265.9m borrowed by the Council in 2011/12 as part of the Housing Self Financing reforms;
- f) Note that the Council did not borrow in 2011/12 to finance its capital programme but utilised internal cash in line with its strategy.

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.

1. Introduction and Background

- 1.1. The Council is required by regulations issued under the Local Government Act 2003 (as amended 2010) to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2011/12.

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).

This report also reviews the external cash portfolio managers for the financial year.

- 1.2 During 2011/12 the Assembly received the following reports:

- an annual treasury strategy in advance of the year (Council 30/03/2011); and
- an annual review following the end of the year describing the activity compared to the strategy (this report).

- 1.3 This Annual Treasury Report covers:

- The Council's treasury position as at 31 March 2012;
- Annual Strategy Statement 2011/12;
- Economic Factors in 2011/12;
- Performance Measurement in 2011/12;
- Borrowing Outturn;
- Treasury Management costs in 2011/12;
- Compliance with Treasury limits and Prudential indicators;

- Lending to Commercial and External Organisations; and
- Housing Revenue Account Reform.

2. Treasury Position as at 31 March 2012

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities.

Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. The Council's treasury position at the start and end of 2011/12 can be found in Table 1:

Table 1: Council's treasury position at the start and end of 2011/12

	31 March 2012 Principal £'000	Rate /Return	Average Life (yrs)	31 March 2011 Principal £'000	Rate /Return	Average Life (yrs)
Fixed Rate Funding:						
PWLB	295,912	3.55%	39.46	30,000	4.06%	2.08
Variable Rate Funding:						
PWLB	0	0	0	0	0	0
Market	40,000	2.37%	56.39	40,000	2.37%	57.52
Total Debt	335,912	3.41%	37.23	70,000	3.09%	34.23
Investments						
In-House	60,736	1.10%		38,790	1.66%	
External Managers:						
Investec	38,743	1.67%		28,292	1.18%	
SWIP	0	0%		11,432	1.19%	
RBS	0	0%		15,000	0.72%	
Total Investments	99,479	1.28%		93,514	1.33%	

3. Annual Strategy Statement 2011/12

3.1 The Assembly approved the annual strategy for 2011/12 on the 30 March 2011.

3.2 The key points from that strategy were:

- To set an authorised borrowing limit of £257m for 2011/12;
- That the Council's borrowing strategy will give consideration to the following when deciding to take up new loans:
 - Use internal cash balances while the current rate of interest on investments remains at an all-time low, with consideration given to

weighing the short term advantage of internal borrowing against potential long term costs if long term borrowing rates begin to increase more than forecast;

- Using Public Works Loan Board (PWLB) variable rate loans;
 - Using long term fixed rate market loans where rates were significantly less than PWLB rates for the equivalent maturity period;
 - Maintain an appropriate balance between PWLB and market debt in the debt portfolio;
 - Use short dated PWLB fixed rate loans where rates are expected to be significantly lower than rates for longer period;
 - Ensure that new borrowing is timed at periods when rates are expected to be low; and
 - Consider the issue of stocks and bonds if appropriate.
- That the Council and its fund managers will have regard to the Council's investment priorities being:
 - (a) The security of capital;
 - (b) The liquidity of its investments; and
 - (c) Yield (after ensuring the above are met).
 - 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;
 - That the Council would operate both borrowing and investment portfolios at short and long term periods and as a consequence reduce the risk of being impacted by a sharp unexpected rise in short-term variable interest rates;
 - That the Council maintain a balance of funding at shorter-term rates to match short-term investments thus maintaining balanced treasury risk;
 - That the Council during the financial year will carefully consider the difference between borrowing rates and investment rates to ensure that the Council obtain value for money; and
 - That the Council will continue to utilise internal borrowing rather than external borrowing as the opportunity arises.

4. Economic Factors in 2011/12

- 4.1 The financial year 2011/12 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk.
- 4.2 The original expectation for 2011/12 was that Bank Rate would start gently rising from quarter 4 2011. However, economic growth in the UK was disappointing during the year due to the UK austerity programme, weak consumer confidence and spending, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the European Union (EU).

- 4.3 The UK coalition government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Key to retaining this rating will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within the austerity plan timeframe.
- 4.4 The USA and France lost their AAA credit ratings from one rating agency during the year. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £75bn in October and another £50bn in February. Bank Rate therefore ended the year unchanged at 0.5% while CPI inflation peaked in September at 5.2%, finishing at 3.5% in March, with further falls expected to below 2% over the next two years.
- 4.5 The EU sovereign debt crisis grew in intensity during the year until February when a second bailout package was eventually agreed for Greece.
- 4.6 Gilt yields fell for much of the year, until February, as concerns continued building over the EU debt crisis. This resulted in safe haven flows into UK gilts which, together with the two UK packages of quantitative easing during the year, combined to depress PWLB rates to historically low levels.
- 4.7 Investment rates. Risk premiums were also a constant factor in raising money market deposit rates for periods longer than 1 month. Widespread and multiple downgrades of the ratings of many banks and sovereigns, continued Eurozone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment. The focus in 2011/12 remained the sovereign debt issues affecting the Euro-Zone rather than individual institutions. Local authorities were also presented with changed circumstances following the unexpected change of policy on 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.

5. Performance Measurement

5.1 Investment Policy

The Council's investment policy is governed by the Department of Communities and Local Government (CLG) guidance, which was implemented in the annual investment strategy approved by the Assembly on 30 March 2011. The policy sets out the Council's approach for choosing investment counterparties.

5.2 Economic Issues Which Directly Impacted Treasury Management Performance

The difference between investment rates and borrowing rates continued to be a major issue for treasury management throughout 2011/12. Borrowing rates did continue to fall throughout 2011 with rates rising slightly during the first quarter of 2012.

Security and liquidity continued to be an issue for both the in-house and investment fund managers, with all investments invested in instruments and counterparties

which may sometimes have generated lower rates of return but higher security and liquidity. As a result investment income continued to fall compared to previous years.

5.3 Overall Performance

The Council earned £1.2million gross of fees in interest from its investments in 2011/12. This represented performance of 1.28%. This performance is against a back drop of 3 Month LIBID un compounded rate of 0.82% and 7 day LIBID un compounded rate of 0.48%.

5.3.1 Specific Performance

Throughout 2011 a proportion of the Council's cash was managed by cash managers – Scottish Widows and Investec. Due to Scottish Widows underperforming throughout the year and projecting to return just over 1.10% for the year, a decision was made to call back the £11.5m. This was paid back to the Council at the beginning of February 2012 and reinvested with Investec.

Investing a portion of the Council's cash in an external fund manager provides diversification and reduces the risk from concentrating investments in a few counterparties, thereby ensuring security of capital. In addition most instruments used the cash managers that can be traded at short notice thereby ensuring that the Council can maintain liquidity of its funds at short notice.

The majority of the Council's in-house investments were made with the partially nationalised UK banks that offer quasi government risk at interest rates much higher than could be achieved from investing with the UK government itself.

A substantial part of the investment portfolio was held in liquidity accounts with main UK banks. These accounts offered instant access at competitive rates, which enabled the treasury management to maintain a very liquid portfolio at a competitive rate of return.

- **In-House Team**

The rate of return for the year was 1.10%. Performance was reduced compared to 2010/11 due to investments being held for less than three months due to the uncertainty raised by the Euro-Zone crisis and following advice from the Council's treasury advisors (Sector).

- **Investec**

The rate of return for the year was 1.67%. Performance in 2011/12 was much improved on the 2010/11 figures.

- **Scottish Widows Investment Partnership (SWIP)**

SWIP's rate of return in 2011/12 to the end of January 2012 was 1.05%. Due to lower than expected returns funds were removed from SWIP and invested with Investec.

5.3.2 Investment Funds Available

The level of investments available to the Council as at 1 April 2011 was £93.5m. 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 2012 the level of investments had increased to £99.5m, with £38.7m held by Investec and £60.8m internally managed. 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 now managed by two sources being:

- Council In House Team; and
- External Fund Manager: Investec Asset Management Limited.

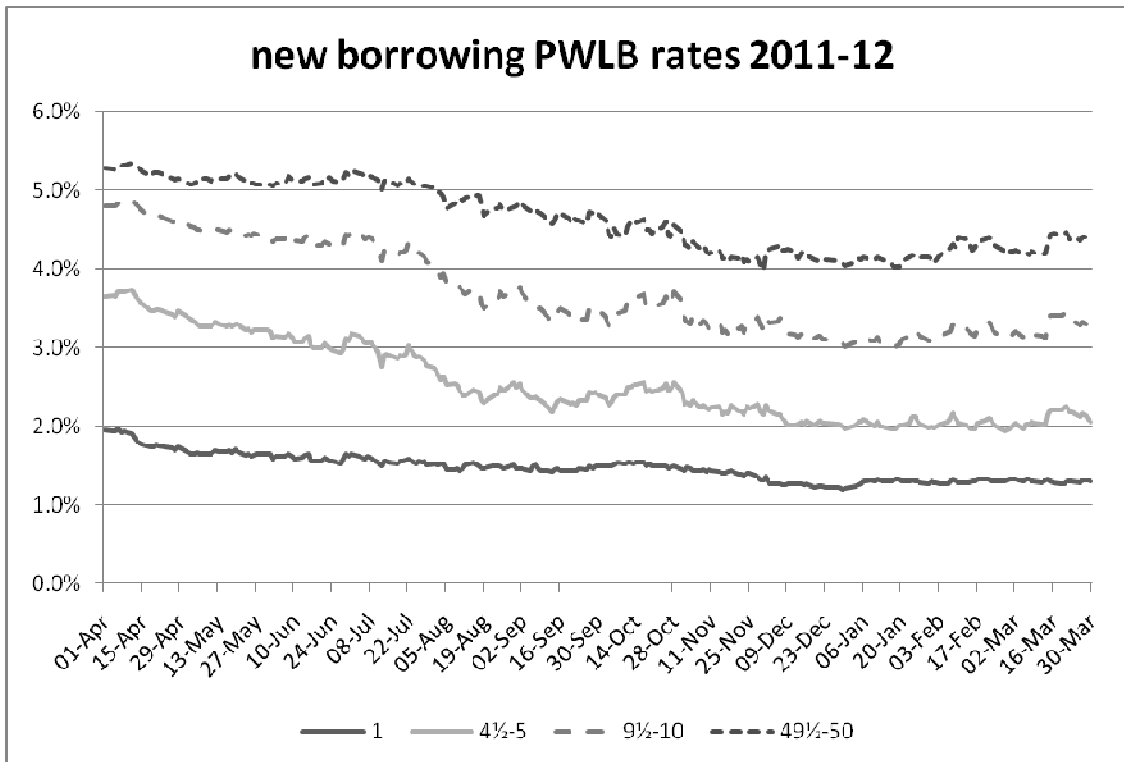
The Council meets quarterly with the external investment managers as well as with its Investment Adviser to discuss financial performance, objectives and targets in relation to the investments and borrowing managed on behalf of the Council.

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 **PWLB borrowing rates** - Graph 1 below shows how PWLB rates fell to historically very low levels during the year.

Graph 1: PWLB rates 2011/12



6.1 Debt Performance

The average debt portfolio interest rate, excluding HRA refinancing, increased slightly over the course of the year as the rate of two variable rate loans increased.

No additional borrowing was made for the General Fund, with cash balances used to finance new capital expenditure in order to run down cash balances and minimise counterparty risk incurred on investments. This strategy provided treasury management budget savings as investments rates were on average over 2% lower than new borrowing rates.

This strategy will be continually reviewed throughout 2012/13, with borrowing in-line with the capital financing requirements potentially made if borrowing rates rise.

6.2 Debt Rescheduling and New Borrowing

Debt rescheduling opportunities remain limited in the current economic climate. Due to the reduction in borrowing rates treasury management did investigate the possibility of restructuring two of the LOBOs held but, following evaluation, it was determined that it would be too expensive to arrange. Therefore there was no debt rescheduling in 2011/12.

As investment rates continued to remain low, the treasury management continued using cash balances rather than borrowing, which helped to keep borrowing costs low and also meant reduced counterparty risk on the investment portfolio. Consequently no new borrowing took place in 2011/12.

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. Treasury management costs are summarised in table 2 below:

Table 2: Treasury Management costs for 2011/12

Salary Recharge	56,675
Treasury Management Software and other costs	3,810
Sector Treasury Limited	19,000
Investec Asset Management	44,417
Scottish Widows	15,177
	139,079

8. Compliance with Treasury limits and Prudential indicators

- 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 1 to this report. In 2011/12, the Council did not bridge its revised authorised limit on borrowing of £465m.
- 8.3 The revised Operational limit set in the 2012/13 Treasury Management Strategy Statement was £367.8m, with the final position of £335.9m.

9. Lending to commercial and external organisations

- 9.1 As part of the Council's 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 embodied in community strategies. The Corporate Director of Finance & Resources determines the rates and terms of such loans.

10. Housing Revenue Account Reform

- 10.1 The implementation of housing finance reform at the end of the year abolished the housing subsidy system financed by central government and, consequently, all housing debt has been reallocated nationally between housing authorities.
- 10.2 The result of this reallocation was that this Council made a capital payment to the CLG of £265.9m on 28 March 2012. This resulted in an increase in the Capital Financing Requirement (CFR) and total borrowing of £465m at the end of the year which was financed by internal borrowing and new external borrowing of £265.9m.
- 10.3 All of the housing finance reform borrowing of £265.9m was made through long dated, fixed rate PWLB loans. The amount, duration and interest rate of these loans is outlined in table 3 below:

Table 3: Housing Finance Loan Summary

Loan Amount	Maturity profile	Interest Rate
<u>£M's</u>	<u>Yrs</u>	<u>%</u>
50.0	30	3.51
50.0	40	3.52
50.0	48	3.49
50.0	49	3.48
65.9	50	3.48
265.9		

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 2011/12 financial year;
 - b) That the value of investments as at 31 March 2011 totalled £99.5million; and
 - c) That the value of long term borrowing as at 31 March 2011 totalled £335.9m. This comprised both market and PWLB loans.

12. Options Appraisal

- 12.1 There is no legal requirement to prepare a Treasury Management Annual Report However, it is good governance to do so and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

13. Consultation

- 13.1 The Corporate Director of Finance and Resources and the Divisional Director of Finance have informed of the approach, data and commentary in this report.

14. Financial Implications

Implications completed by: Jonathan Bunt
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- 14.1 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.

15. Legal Implications

Implications completed by: (Eldred Taylor-Camara, Legal Group Manager)

- 15.1 The legal requirements are stated in the body of this report. There are no further legal implications to add.

16. Risk Management

- 16.1 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.

17. Contractual Issues No specific contractual issues.

18. Staffing Issues No staffing issues.

19. Customer Impact No specific implications.

20. Safeguarding Children No specific implications.

21. Health Issues No specific implications.

22. Crime and Disorder Issues No specific implications.

23. Property / Asset Issues No specific implications.

Background Papers Used in the Preparation of the Report:

- Treasury Management Strategy Statement - Assembly Report 14 February 2012
- Treasury Management Strategy Statement - Assembly Report 30 March 2011
- CIPFA – Revised Treasury Management in the Public Sector
- CIPFA – Revised Prudential Code for Capital Finance in Local Authorities
- HRA Business Plan V7 (16 Jan 2012)

List of appendices:

Appendix 1 - Treasury Management Outturn Report 2011/12
Appendix 2 - Glossary of Terms