AUD011
FOR DECISION
WARD(S): ALL

AUDIT COMMITTEE

26 September 2011

TREASURY MANAGEMENT STEWARDSHIP REPORT FOR 2010/11

REPORT OF HEAD OF FINANCE

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RECENT REFERENCES:

CAB1960 : Treasury Management Strategy 2010-11, 3 February 2010
PS418: Treasury Management Informal Scrutiny Group, 12 July 2010
CAB2042: Treasury Management Stewardship 2009-10, 15 September 2010
CAB2079: Treasury Management Mid Year Review 2010-11, 8 December 2010
CAB2117: Treasury Management Strategy 2011-12, 9 February 2011
AUD004: Treasury Management Policy & Practices, 29 June 2011

EXECUTIVE SUMMARY:

This report provides information on the stewardship of the Treasury Management function for the financial year 2010/11 and comments on treasury management activity during that financial year.

The Head of Finance confirms that no external borrowing was undertaken in 2010/11.

Appendix A provides the Actual Prudential Indicators.

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. The outlook for growth was uncertain due to consumers and corporates trimming their spending and financial institutions exercising restraint in new lending:

- £1,000,000 invested with Heritable Bank plc in Administration. At 31 March 2011 the Council had received £502,803 from the Administrator and received a further £103,445 in 2011-12 to date. The forecast was for an expected 85% recovery.

Interest rates remain at a historically low level, Bank rate has now been at 0.5% since March 2009.

RECOMMENDATIONS:

That the Audit Committee approves the Treasury Management Stewardship Report for 2010/11 and the Actual 2010/11 Prudential Indicators at Appendix A.

AUDIT COMMITTEE

26 SEPTEMBER 2011

TREASURY MANAGEMENT STEWARDSHIP REPORT FOR 2010/11

REPORT OF HEAD OF FINANCE

1 Introduction

1.1 The Council operates its treasury management service in compliance with the *Code of Practice for Treasury Management in the Public Services*, the *Prudential Code for Capital Finance in Local Government* (both published by CIPFA) , the *Guidance on Local Government Investments* and Minimum Revenue Provision Statement Statutory Guidance (both published by DCLG). The prime objective of the treasury management activity is the effective management and control of risk.

1.2 The Codes require the regular reporting of treasury management activities, forecasting likely activity for the forthcoming year (in the Annual Treasury Strategy Report – CAB1960), a mid year review CAB2079 and reporting on actual activity for the preceding year (this report).

1.3 This report covers:

- The capital activity for 2010/11
- The strategy agreed for 2010/11
- Performance indicators for 2010/11
- A summary of the economic factors affecting the strategy during 2010/11
- The Council's treasury position at the year end
- Borrowing
- Investments
- The compliance of the treasury service with internal and external requirements
- Treasury Management Advisers

2 The Council's Capital Expenditure and Financing 2010/11

2.1 The Council undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.); or
- If insufficient financing is available, or a decision is taken not to apply resources, the expenditure will give rise to a borrowing need.

2.2 The Council has previously fully financed its capital expenditure; however in 2009-10 capital expenditure was not fully funded creating a Capital Financing Requirement (CFR). The CFR increased further in 2010-11.

2.3 The actual capital expenditure forms one of the required prudential indicators (Appendix A). The table below also shows how this was financed:

Capital programme	**2009/10 Actual £000's**	**2010/11 Estimate £000's**	**2010/11 Actual £000's**
General Fund	8,068	13,800	5,639
HRA capital expenditure	3,001	4,600	4,236
Total capital expenditure	**11,069**	**18,400**	**9,875**
Resourced by:			
Capital receipts	3,460	2,800	1,041
Capital grants & contributions	1,180	2,100	1,227
Major repairs allowance	2,924	3,400	3,497
Major investment reserve	351	1,200	763
Other reserves	552	1,500	1,756
Total Resources Applied	**8,467**	**11,000**	**8,284**
Unfinanced Capital Expenditure	**2,602**	**7,400**	**1,591**

2.4 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position. It represents the capital expenditure which has not yet been paid for by revenue or other resources.

2.5 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The Council's Capital Financing Requirement is currently funded using temporary cash resources from the Council's own working capital.

2.6 **Reducing the CFR** – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual Treasury Strategy, the Council is legally required to make an annual revenue charge to reduce the General Fund CFR. The CFR of £1,591k incurred in the year was all GF, HRA capital expenditure was fully funded.

2.7 The statutory revenue charge is called the Minimum Revenue Provision (MRP). The total CFR can also be reduced by:

a) The application of additional capital resources, such as unapplied capital receipts, or

b) charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

2.8 The Council's MRP policy (as required by CLG Guidance) was included in Treasury Management Strategy CAB1960. The MRP in 2010-11 was £39k.

3 Treasury Management Strategy for 2010/11

3.1 The Treasury Management Strategy for 2010/11 was approved by Council on 18 February 2010 (CAB1960 refers) and a mid year review was reported to Cabinet on 8 December 2010 (CAB2079 refers). The markets remain nervous and volatile. The Head of Finance in consultation with the Council's Treasury Management consultants from time to time further restricts the list of acceptable banks etc. (the counterparty list) that the Council will invest with.

3.2 It should be noted that the accounting practice required to be followed by the Council (the SoRP) requires financial instruments in the statutory accounts (debt, investments, etc.) to be measured in a method compliant with national Financial Reporting Standards. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

4 Performance Indicators

4.1 The following treasury management indicators were set for 2010/11:

a) Debt – Borrowing - Average rate of borrowing for the year compared to average available.

b) Debt – Average rate movement year on year.

c) Investments – Internal returns above the Bank Base Rate.

d) Investments – External fund managers - returns 110% above 7 day compounded LIBID.

4.2 Performance against these indicators was as follows:-

a) Not applicable, no debt.

b) Not applicable, no debt.

c) Investments:

- 0.5% Bank base rate which remained unchanged during the year
- 1.0% was the average rate achieved excluding Heritable Bank
- 0.5% in excess of the performance indicator
- An additional £122,000 benefit to the Council based on average balance invested of £24,854,000.

d) Not applicable as no investment was managed by external fund managers.

5 Economic Background for 2010/11

5.1 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. 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

5.2 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; 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. Significant cuts were made to public expenditure, in particular local government funding.

5.3 The credit crisis migrated from banks to European sovereigns. The ratings of Ireland and Portugal were downgraded to the 'triple-B' category whilst the rating of Greece was downgraded to sub investment (or 'junk') grade. The sovereign rating of Spain was also downgraded but remained in the 'double-A' category. The results from the EU Bank Stress Tests, co-ordinated by the Committee of European Banking Supervisors, highlighted that only 7 out of the 91 institutions failed the 'adverse scenario' tests. The tests were a helpful step forward, but there were doubts if they were far-reaching or demanding enough. The main UK banks' (Barclays, HSBC, Lloyds and RBS) Tier 1 ratios all remained above 9% under both the 'benchmark scenario' and the 'adverse scenario' stress tests.

5.4 Gilts benefitted from the decisive Comprehensive Spending Review (CSR) plans as well as from their relative 'safe haven' status in the face of European sovereign weakness. 5-year and 10-year gilt yields fells to lows of 1.44% and 2.83% respectively. However yields rose in the final quarter across all gilt maturities on concern that higher inflation would become embedded and greatly diminish the real rate of return for fixed income investors.

5.5 The accommodative policy approach, coupled with dwindling fears of financial collapse, created an environment in which money market rates eased to yet lower levels. In addition to this, the margin between borrowing and investment rates returned to a more normal position. This was a sign that banks were more comfortable about transacting business between each other but the availability of credit to a wider cross-section of the economy remained problematic through to year-end.

6 The Council's treasury position at the year end

Summary	31 March 2011		31 March 2010	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	0	0%	0	0%
Variable Interest Rate Debt	0	0%	0	0%
Total Debt	**0**	**0%**	**0**	**0%**
Short -term Fixed Interest Investments (excluding Heritable bank- see below)	£8.00m	1.13%	£14.50m	0.57%
Short-term Variable Rate Investments	£5.53m*	0.68%	£3.80m*	0.57%
Long-term Variable Interest Investments	£1.00m	6.68%	£1.00m	5.99%
Total Investments	**£14.53m**	**1.34%**	**£19.30m**	**0.85%**

* includes Bank current account balance

7 Borrowing

7.1 Following the decision of Council on 27 February 2002 all long-term debt was prematurely repaid.

7.2 In the period 1t April 2010 to 31 March 2011 no loans were taken, nor was the agreed bank overdraft facility used.

8 Short Term Investments

8.1 Investment policy - The Council's investment policy is governed by CLG Guidance, which was updated 1 April 2010 and reiterated the need to focus on security and liquidity, rather than yield. It also recommended that strategies include details of assessing risk, reasons for borrowing in advance of need and the use of treasury advisers. This has been implemented by the annual investment strategy approved by Council on 18 February 2010 (CAB1960 refers). A mid year review was reported to Cabinet on 8 December 2010 (CAB2079 refers). The markets remain nervous and volatile, the Head of Finance in consultation with the Council's Treasury Management consultants from time to time further restricts the list of acceptable banks etc. (the counterparty list) that the Council will invest with.

8.2 The Council maintained an average balance of £24.9 million of internally managed funds achieving a return of 1.0%. The comparable performance indicator is the average Bank rate, which was 0.5%.

8.3 During the year 2010-11 (2009-10), 111 (211) short term investments were made for on average 53 (39) days in the average sum of £1.3m (£1.4m) as well has having 2 (2) call accounts and the current account which generates a return. The investments that were held at 31 March 2011 are shown in Appendix B.

8.4 Heritable Bank is a UK registered bank under Scottish law. The company was placed in administration on 7 October 2008. A total repayment of £503k (50.30%) had been received at 31 March 2011, and the revised impairment is based on the assumption that a further 34.9% will be received by the end of 2012/13, taking the total dividends expected to be paid to 85.2%.

Therefore, in calculating the impairment the Council has made the following assumptions about the timing of recoveries:

Date	**Repayment**	**Date**	**Repayment**
April 2011	6.25%	April 2012	5%
July 2011	5%	July 2012	5%
October 2011	5%	October 2012	3.65%
January 2012	5%		

9 Long Term Investments

9.1 The only long-term investment the Council holds is with the Local Authorities Mutual Investment Trust (LAMIT). A property investment of £1 million was made in March 1990, with the General Fund receiving the investment income.

9.2 As at 31 March 2011 the value of this investment has risen to £0.962 million (£0.913 million at 31 March 2010), but remains impaired (that is below cost price). The impairment of £38k has previously been deferred in accordance with legislation, statutory instrument 2009/321, as it is expected to be a temporary situation caused by the current financial crisis. This statutory deferment was only temporary to the 31 March 2010 and the £38k impairment has been recognised in the comprehensive income & expenditure statement in 2010-11. Dividends of £66,812 were received in 2010/11 (6.68%).

10 Regulatory Framework, Risk and Performance

10.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance;

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2010/11);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the DCLG has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 11 March 2010.

10.2 The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

10.3 The Head of Finance can report that the investment portfolio has been managed within the Counterparty limits except on two occasions where the current account limit of £3m was exceeded. These were: £3.6m (£0.6m over the limit) on the 10 May and £3.3m (£0.3m over the limit) on the 5 August. Both cases involved miscommunication between Bank/ Brokers & the Council and money being put into our bank account late in the day. Cash flow forecasting has been revisited and improved to minimise the risk of this happening again. This was previously reported in the 2010-11 mid year review, CAB2079. The Head of Finance has been given discretionary powers for 2011-12, CAB2117 to authorise on a daily basis an additional £1m on the current account.

11 Treasury Management Advisers

11.1 During 2010/11 Sector (formerly Butlers) continued to act as the Council's treasury management advisers offering support and advice on treasury management activities, which was taken up on a number of occasions. On the 1st April 2011 Arlingclose Ltd became the Council's treasury management advisers.

OTHER CONSIDERATIONS:

12 SUSTAINABLE COMMUNITY STRATEGY AND CHANGE PLANS (RELEVANCE TO):

12.1 Treasury Management supports all tenets of the Sustainable Community Strategy as well as the core value of being efficient and offering value for money.

13 RESOURCE IMPLICATIONS:

13.1 Interest and investment income amounted to £245k in 2010-11 (£370k in 2009/10).

14 RISK MANAGEMENT ISSUES

14.1 These are considered within the report.

BACKGROUND DOCUMENTS:

Operational and financial records held in the Financial Services Team.

APPENDICES:

Appendix A - Actual Prudential Indicators for 2010/11

Appendix B - Investments held at 31 March 2011

TREASURY MANAGEMENT STEWARDSHIP REPORT

Capital programme	2009/10 Actual £000's	2010/11 Estimate £000's	2010/11 Actual £000's
General Fund	8,068	13,800	5,639
HRA capital expenditure	3,001	4,600	4,236
Total capital expenditure	**11,069**	**18,400**	**9,875**
Resourced by:			
Capital receipts	3,460	2,800	1,041
Capital grants & contributions	1,180	2,100	1,227
Major repairs allowance	2,924	3,400	3,497
Major investment reserve	351	1,200	763
Other reserves	552	1,500	1,756
Total Resources Applied	**8,467**	**11,000**	**8,284**
Unfinanced Capital Expenditure	**2,602**	**7,400**	**1,591**

General Fund, Affordability Prudential Indicator	2009/10 Actual £000's	2010/11 Actual £000's
Actual Capital Expenditure	8,068	5,639
Capital Financing Requirement	2,602	1,591
	%	%
Financing costs as a proportion of taxation and non specific grant income	0.1	0.2

Housing Revenue Account, Affordability Prudential indicator	2009/10 Actual £000's	2010/11 Actual £000's
Actual Capital Expenditure	3,001	4,236
Capital Financing Requirement	10,100	10,100
	%	%
Financing Costs as a proportion of Housing Rents	0.4	0.3

Capital Financing Requirement (CFR) £000's	31 March 2010 Actual	31 March 2011 Original Indicator	31 March 2011 Actual
Opening Balance	0	3,078	2,602
2009-10 unfinanced capital	2,602	8,289	1,591
Less Minimum Revenue Payment	0	(50)	(39)
Less Voluntary Revenue Payment	0	0	0
Closing Balance	2,602	11,317	4,154

P. I. Net Borrowing should not exceed CFR except in the short term £000's	31 March 2010 Actual	31 March 2011 Original Indicator	31 March 2011 Actual
Net borrowing position	0	0	0
CFR	2,602	11,317	4,154

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Appendix B

TREASURY MANAGEMENT STEWARDSHIP REPORT

Investments & Bank as at 31 March 2011

	31 March 2011			
Tier 1 UK Government	**£**	**Repayment Date**	**Rates %**	
Local Authorities: Salford City Council	1,000,000	28-Jun-11	0.65	
Local Authorities: Plymouth City Council	1,000,000	01-Apr-11	0.50	
Local Authorities: Leeds City Council	1,000,000	13-May-11	0.55	
Local Authorities: Hull City Council	1,000,000	20-Jun-11	0.60	
Total Tier 1	**4,000,000**		**0.58**	
Tier 2 UK Banks with significant Government Shareholdings				
National Westminster Bank Current Account	2,531,378	Current Account	0.80	Variable
Bank of Scotland Call Account (Lloyds Bank Group)	2,000,000	Call Account	0.50	Variable
Bank of Scotland Term Deposit (Lloyds Bank Group)	1,000,000	05-Jan-12	2.40	
Total Tier 2	**5,531,378**		**0.98**	
Tier 3 A Rated UK Banks eligible institutions of the 2008 Credit Guarantee Scheme				
Close Brothers	1,000,000	1 Day Call Account	0.75	Variable
NM Rothschild & Sons	1,000,000	12-Oct-11	1.20	
Santander UK Plc	1,000,000	14-Sep-11	1.41	
Total Tier 3	**3,000,000**		**1.12**	
Tier 4 A Rated UK Building Societies eligible institutions of the 2008 Credit Guarantee Scheme				
Nottingham	1,000,000	05-Jul-11	1.75	
Remaining Building Society limit	-		0.00	
Total Tier 4	**1,000,000**		**1.75**	
All Short Term Funds	**13,531,378**		**0.95**	
Long Term Investments				
Local Authorities Mutual Investment Trust*				
Principal	1,000,000	Flexible	6.68	Variable
Impairment	(37,913)			
Net Book Value	962,087			
Total Bank & Investments	**14,531,378**		**1.34**	