Appendix A

Treasury Management Outturn Report 2010-11

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Introduction and Background

1. The Council's Treasury Management function is concerned with the management of the Council's debts, investments, cashflow and banking arrangements. These activities are regulated by a variety of professional codes, statutes and guidance. More specifically, treasury management in this context is defined as:-

   "The management of the local authority's 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. "

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

3. It is a requirement of the Council's Treasury Management Policy that a report is presented to the Council's Executive providing details of the treasury management activities undertaken in the preceding financial year. In-year monitoring reports are presented to the Accounts and Audit Committee. This annual report provides Councillors with the following information for 2010/11:-

   i) Economic Commentary on the year
   ii) Borrowing Activity
   iii) Investment Activity
   iv) Compliance with Treasury Limits
   v) Banking Facilities
   vi) Treasury Management Advisors

4. Recent changes in the regulatory environment place a much greater onus on Members for the review and scrutiny of treasury management policy and activities. This 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 Members.

Economic Commentary for 2010/11

5. **Appendix 1** sets out the economic background and provides an overview of the market conditions in which the Council's treasury management function has been carried out during 2010/11.

6. The maintenance of a low interest rate environment and the continuing instability in the financial markets have both impacted on the Council's ability to lend funds and achieve a reasonable return. The focus of the investment strategy remains the protection of the Council's capital investment over the returns achieved. To this end, we have been pursuing a strategy of primarily using internal borrowing to fund capital investment reflecting the limited returns on investment compared with the cost of borrowing.

Borrowing Activity

Long Term Borrowing

7. At the start of 2010/11 the Council had long-term debt of £9.109m, comprised wholly of Public Works Loan Board (PWLB) loans. During the year, there have been the following changes in the Council's debt portfolio:-

   a) additional PWLB loan debt of £2.0m was taken on 14th June 2010. This comprised two loans of £1m each with durations of c10 years and c15 years respectively. These loans were taken because of the expectation that interest rates will rise in the future

   b) repayment of a PWLB loan of £1m which expired on 31st July 2010;

   c) repayment of a PWLB loan of £2.250m which expired on 29th January 2011.

8. The balance of the Council's long term debt as at 31st March 2011 was £7.859m (although technically it should be noted that the debt comprises £5.859m of long-term debt and £2m of short-term debt as this falls due for repayment in 2011/12). An analysis of the Council's debt portfolio (and how it has changed since 1st April 2010) is provided at **Appendix 2,** whilst **Appendix 3** provides an analysis of the maturity dates for this debt. The average cost of this debt is 3.91% (which is higher than at the beginning of the financial year when it was 3.32%).

9. The General Fund Revised Budget for debt charges for 2010/11 was £676,780 comprising £344,120 for interest on debt, £331,480 for the minimum revenue provision and £1,180 for premia payable as a result of debt restructuring exercises in previous years. Actual debt charges for the year were (including MRP and premia) £674,417, a saving of £2,363 when compared to the budget.

Short Term Borrowing

10. Subject to daily cashflow requirements, the Council may borrow funds on a temporary basis to meet cashflow deficits; this is a normal part of the treasury management process. During 2010/11 no temporary borrowing was required.

Investment Activity

11. The Council manages its in investments in-house. All investments were placed with institutions authorised in accordance with the Council's Treasury Management Strategy and Approved Lending List. Investments are made for a range of periods, dependent on cashflow requirements, interest rate projections and interest rates on offer, with a maximum duration of 364 days.

12. The Council started the year with investments of £8.5m increasing to £14.5m by 31st March 2011. The level of investment activity is summarised in table 1 below:-

Table 1: Investment Activity 2010/11

	£m	No.
Opening Balance	8.500	4
New Investments	193.225	145
Investments Realised	(187.225)	142
Balance of Investments at 31st March 2011	**14.500**	**7**

13. As the table indicates, a total of 145 investments amounting to £193.225m were placed at throughout the year, the details of which have been reported to the Accounts and Audit Committee in regular monitoring reports. A summary of all investments placed and realised during the year is provided at **Appendix 4** which also shows the interest rate of return with each Counterparty. A graph showing the balance of amounts under investment during the year is provided at **Appendix 5**.

14. The Approved Budget for interest and investment income for 2010/11 on the General Fund was £130,500 whilst the actual level achieved was £204,771, some £74,271 more than budgeted. The sum of £183,521 was earned from investments as shown in **Appendix 4**. The main reasons why investment income exceeded the budget is due to higher than forecast cash balances owing to the receipt in full of HMR monies combined with a significant underspend on the Council's Capital Programme as reported to the Executive in June 2011.

15. In relation to investment performance for 2010/11, the actual return on investments is a function of the amount of surplus cash available, the timing and duration of investments and the interest rates at which any such funds are invested. As the Council's investments are restricted to cash deposits (to authorised counterparties), the interest returns achieved are generally linked to the bank base rate as determined by the Monetary Policy Committee (MPC). The tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in the shorter term deposit rates. The Bank Rate remained at its historical low of 0.5% throughout the year, although growing market expectations of the imminence of the start of monetary tightening late in the year did see 6 and 12 month rates picking up.

16. Overlaying the relatively poor investment returns were continuing concerns regarding counterparty quality, evidenced by the Euro zone sovereign debt crisis which resulted in rescue packages for Greece, Ireland and latterly Portugal. Concerns extended to the European banking industry with an initial stress testing of banks failing to calm counterparty fears, resulting in a second round of testing currently in train. This emphasised the ongoing need for caution in treasury investment activity.

17. Overall, the Council achieved a return on investments of 1.06%. Investment durations have spanned money lent overnight to investments of 364 days. This level of return compares favourably with the average 7 day (uncompounded) LIBID return of 0.43% or the 6 month (uncompounded) LIBID return of 0.90%.

Prudential Indicators and Compliance Issues

18. The Council is required by the Prudential Code (for Capital Finance in Local Authorities) to report the actual prudential indicators after the year end. Certain of these indicators provide either an overview or a limit on treasury activity, and these are shown below in Table 2 below:-

Table 2: Net Borrowing and Capital Financing Requirement 2010/11

	2010/11 Budget Indicator £000	2010/11 Outturn Indicator*1,2 £000	Change £000
Net Borrowing / (Investment) position	1,184	(6,641)	(7,825)
Capital Financing Requirement (CFR)	16,730	8,268	(8,462)

*1. Comprises external debt of £7.859m less external investments of £14.5m
*2. The CFR shown for 10/11 Outturn is provisional at this stage pending the audit of the Council's accounts

19. The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, and this can be used to gauge the Council's actual debt position as outlined in paragraph 8 above.

20. It is a fundamental requirement that the Council only borrows for the purposes of capital expenditure (and not revenue expenditure). To ensure that over the medium term borrowing net of investments will only be for a capital expenditure, net borrowing should not, except in the short term, exceed the CFR. As table 2 indicates, the CFR at 31st March 2011 is £8.268m compared with the Council's net investment position of £6.641m. Therefore net borrowing did not exceed the CFR.

21. Ensuring that actual external debt remains affordable, prudent and sustainable by the Council is a fundamental requirement of the Prudential Code which requires the Council to establish an Authorised Limit and an Operational Boundary for the overall quantum of actual debt. The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary are acceptable subject to the Authorised Limit not being breached.

22. Table 3 below shows the Council's gross borrowing position at 31st March 2011 compared to both the Authorised Limit and the Operational Boundary:-

Table 3: Performance Against Authorised Limit and Operational Boundary

	2010/11 Outturn Indicator £M
Authorised Limit*1	14.0
Operational Boundary*1	12.0
Actual Gross Borrowing Position	7.9

*1 – Excludes approved bank overdraft limit of £0.5m

23. While table 3 above shows the year-end position, provided at **Appendix 1** is a graph that shows performance against the limits for 2010/11 as a whole. This shows the Council did not exceed the operational boundary at any point during 2010/11. Under the Prudential Code for Capital Finance in Local Authorities, it is permissible for the occasional, but not sustained, breach of the operational boundary. At no time did the Council exceed the Authorised Limit and therefore the Council complied with the prudential limits for external debt during 2010/11.

Banking Facilities

24. The Council currently obtains its banking facilities from Lloyds TSB Bank Plc. The cost of the contract with Lloyds in 2010/11 was £12,450 which was a saving of £2,420 when compared with the budget.

25. During the year, periodic meetings were held with Bank officials to discuss issues of mutual interest and these are ongoing. The service provided by Lloyds TSB Bank Plc includes an authorised overdraft facility of £500,000.

26. Regular monitoring is undertaken of the Council's cash balances with a particular focus on ensuring that all surplus cash is, where possible, invested in accordance with the Annual Investment Strategy. As a target, the Council has previously aimed to have an average cash balance in the range of +/-£50k. However, given the significant reduction in the base rate, and

consequent reduction in investment rates, on occasion it has been more cost effective to retain surplus cash in the current account. This is reflected in the variations in current account balance as shown at **Appendix 6** details of which have been reported to the Accounts and Audit Committee during the year.

External Advisors

27. The Council retained Sector Treasury Services as its treasury management advisors at an annual cost of c£8k in 2010/11.

28. Regular meetings were held with Sector to assess the Council's progress in relation to the Treasury Management Strategy. In addition to daily advice on issues such as PWLB Rates, Sector provides the Council with a regular stream of information on treasury management and capital financial issues including institutional/sovereign credit ratings. Sector also assist the Council with:-

    - the preparation and review of the Annual Treasury Management Strategy;
    - advice on Treasury Management Practice notes and associated Schedules; and
    - reviews of the Counterparty lending list in the light of the changes to investment regulations.

29. There are no matters to report with regard to the level of service provided under the arrangement with Sector although this is subject to periodic review.

Supporting Appendices

Appendix 1 - Economic Commentary 2010/11
Appendix 2 - Analysis of Long/Short Term Borrowing compared to Borrowing Limits 2010/11
Appendix 3 - Maturity Structure of current long term debt
Appendix 4 - Investment Returns 2010/11
Appendix 5 - Investment Balances 2010/11
Appendix 6 - Daily Cashflow Balances 2010/11

Appendix 1

The Economy and Interest Rates

2010/11 proved to be another watershed year for financial markets. Rather than a focus on individual institutions, market fears moved to sovereign debt issues, particularly in the peripheral Euro zone countries. 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.

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 inclement weather conditions. The year finished with prospects for the UK economy being decidedly downbeat over the short to medium term while the Japanese disasters in March, and the Arab Spring, especially the crisis in Libya, caused an increase in world oil prices, which all combined to dampen international economic growth prospects.

The change in the UK political background was a major factor behind weaker domestic growth expectations. The new coalition Government struck an aggressive fiscal policy stance, evidenced through heavy spending cuts announced in the October Comprehensive Spending Review, and the lack of any “giveaway” in the March 2011 Budget. Although the main aim was to reduce the national debt burden to a sustainable level, the measures are also expected to act as a significant drag on growth.

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. Expectations of further quantitative easing also helped to push yields to historic lows. However, this positive performance was mostly reversed in the closing months of 2010 as sentiment changed due to sharply rising inflation pressures. These were also expected (during February / March 2011) to cause the Monetary Policy Committee to start raising Bank Rate earlier than previously expected.

The developing Euro zone peripheral sovereign debt crisis caused considerable concerns in financial markets. First Greece (May), then Ireland (December), were forced to accept assistance from a combined EU / IMF rescue package. Subsequently, fears steadily grew about Portugal, although it managed to put off accepting assistance till after the year end. These worries caused international investors to seek safe havens in investing in non-Euro zone government bonds.

Deposit rates picked up modestly in the second half of the year as rising inflationary concerns, and strong first half growth, fed through to prospects of an earlier start to increases in Bank Rate. However, in March 2011, slowing actual growth, together with weak growth prospects, saw consensus expectations of the first UK rate rise move back from May to August 2011 despite high inflation. However, the disparity of expectations on domestic economic growth and inflation encouraged a wide range of views on the timing of the start of increases in Bank Rate in a band from May 2011 through to early 2013. This sharp disparity was also seen in MPC voting which, by year-end, had three members voting for a rise while others preferred to continue maintaining rates at ultra low levels.

Risk premiums were also a constant factor in raising money market deposit rates beyond 3 months. Although market sentiment has improved, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, mean that investors remain cautious of longer-term commitment. The European Commission did try to address market concerns through a stress test of major financial institutions in July 2010. Although only a small minority of banks “failed” the test, investors were highly sceptical as to the robustness of the tests, as they also are over further tests now taking place with results due in mid-2011.