TELFORD & WREKIN COUNCIL

AUDIT COMMITTEE – 26 JUNE 2012

TREASURY MANAGEMENT - 2011/12 ANNUAL REPORT AND 2012/13 UPDATE

REPORT OF THE ASSISTANT DIRECTOR: FINANCE, AUDIT AND IG (AND SECTION 151/CHIEF FINANCE OFFICER)

1. PURPOSE

1.1 To update members on the 2011/12 Treasury outturn and activities this year to date.

2. RECOMMENDATIONS

Audit Committee Members are asked to note:-

2.1 the contents of the report
2.2 the change to counterparty selection criteria in 16.5
2.3 the performance against Prudential Indicators

3. SUMMARY IMPACT ASSESSMENT

COMMUNITY IMPACT	Do these proposals contribute to specific priority plan objectives?	
	Yes/~~No~~	Effective financial management underpins all priority objectives
	Will the proposals impact on specific groups of people?	
	~~Yes~~/No	
TARGET COMPLETION / DELIVERY DATE	Part of ongoing Treasury Management Activities within the Treasury Management Strategy and Policy approved by Council.	
FINANCIAL/VALUE FOR MONEY IMPACT	Yes/~~No~~	Where appropriate these are detailed in the body of the report**.**
LEGAL ISSUES	Yes/~~No~~	The Section 151 Officer has responsibility for the administration of the financial affairs of the Council. In providing this report the AD: FA&IG is meeting one of the responsibilities of the post contained within the Council's Constitution at Part 2, Article 12, paragraph 12.04(f) which states "The Chief financial Officer will contribute to the promotion and maintenance of high standards of governance, audit, probity and propriety, risk management and the approval of the statement of accounts through provision of support to the Audit

		Committee**.**”
OTHER IMPACTS, RISKS AND OPPORTUNITIES	Yes/~~No~~	The key opportunities and risks associated with treasury management activities are set out in the body of the report and in the Treasury Management Strategy and Policy approved by Council and will be regularly monitored throughout the year.
IMPACT ON SPECIFIC WARDS	~~Yes~~/No	

PART B – ADDITIONAL INFORMATION

4. SUMMARY

The report updates members on the outcome of Treasury Management activities for 2011/12 and details the position for 2012/13 to date.

2011/12 Treasury Outturn

The treasury portfolio ended the year with net indebtedness of £94.6m (borrowing: £147.7m less investments: £53.1m). Base rate was 0.5% for the whole year and is predicted to stay at 0.5% until late 2015 – although recently Christine Lagarde of the IMF suggested that the bank of England consider a further reduction.

The borrowing strategy for 11/12 was to use maturing investments to reduce borrowing where possible. During the year, two PWLB loans matured and one was entered into to take advantage of favourable interest rates. Short term borrowing was used to fund short term cash flow requirements, also at favourable interest rates. The average debt portfolio interest rate has fallen over the course of the year from 3.6% to 3.41%.

The investment strategy for 11/12 was to gain maximum benefit with security of capital being the primary consideration. The average return on investments for the year was 3.46% against a benchmark of 0.52%; further, comparative information from our treasury advisors, Arlingclose, highlights that our rate of return is significantly higher than their other local authority clients.

During the year, a decision was taken to seek repayment of a £5m investment with Dexia, a Franco/Belgian owned bank due to concerns over their exposure to Greece. Full repayment of the principal was received with all accrued interest in November 2011.

Overall, treasury delivered a net over-achievement of £0.496m against the budget in 2011/12.

2012/13 Update

The strategy for 2012/13 remains consistent with that of the previous year. Investment opportunities will be reviewed as they arise, where possible maturing investments will be used to reduce the need to borrow, and we will seek to gain maximum benefit within the agreed risk parameters.

At the end of May, one PWLB loan had matured and no new long term borrowing had been entered into. Investments were £63.15m at 31 May 2012.

Prudential Indicators

There are no breaches of the Prudential Indicators set at Full Council on 1 March 2012 and none have been amended.

5. **PREVIOUS MINUTES**

Council 3 March 2011
Audit Committee 27 June 2011
Council 1 March 2012

6. **BACKGROUND**

Treasury Management in local government is regulated by the 2001 revision of the CIPFA Treasury Management in Public Services : Code of Practice (the Code). This Council has adopted the Code and fully complies with its requirements. The primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement, which states the policies and objectives of its treasury management activities. The Treasury Strategy was approved by Full Council in March 2012.

A requirement of the Council's Treasury Management Practices is the reporting to the Council of both the expected treasury activity for the forthcoming financial year (the annual treasury strategy statement) and subsequently the results of the Council's treasury management activities in that year (this annual treasury report).

7. **2011/12 ANNUAL REPORT**

The annual report is covered in paragraphs 7-15 and deals with: -

- 2011/12 - Overall Portfolio position;
- 2011/12 - Borrowing;
- 2011/12 - Investments;
- Shropshire County Council debt
- Overall outturn position
- Compliance with Treasury Limits
- Leasing

8. **<u>2011/12 OVERALL PORTFOLIO POSITION</u>**

The Council's treasury management position at the beginning and the end of the year was as follows: -

	31 March 2012		31 March 2011	
	Principal £m	**Rate %**	**Principal £m**	**Rate %**
Borrowing	147.670	3.41	130.905	3.60
Total Debt	**147.670**	**3.41**	**130.905**	**3.60**
Investments	53.060	3.46	75.678	3.63
Total Investments	**53.060**	**3.46**	**75.678**	**3.63**
Net Indebtedness	**(94.610)**		**(55.227)**	

A combination of new borrowing plus funds from maturing investments were used as funding for the capital programme. This has resulted in borrowing increasing during the year and investments reducing.

The Adopted Treasury Strategy was to:-

- Monitor borrowing opportunities determined by the prevailing markets.
- To use maturing investments to reduce borrowing where possible
- Reduce the volatility of investment returns while maintaining adequate flexibility in arrangements.
- To achieve optimum return on investments commensurate with proper levels of security and liquidity.

9. **<u>COUNCILS RESPONSE TO ECONOMIC CLIMATE</u>**

9.1 2011/12 saw continued problems with both sovereign and individual bank credit ratings. Base rate remained at 0.5% throughout the whole of 2011/12. The UK economy has dipped back into recession. Base rate is generally predicted to stay at 0.5% until late 2015.

9.2 The Council has reduced both the amount and duration of it's investments and as other investments mature, total investments will be reduced further. These funds were used to reduce the need to borrow, reduce investment risk and volatility.

9.3 We have closely followed guidance issued by our Treasury Advisors in relation to credit ratings, financial standing and duration throughout the year.

10. **<u>2011/12 BORROWING</u>**

10.1 **Original Economic Projections**

When the budget was set for 2011/12 the "average" City view anticipated that Bank Rate would remain at 0.5% until mid 2011 before starting to rise gradually back towards more normal levels in 2012, though it would be 2015 before Bank Rate returned to around 4.5%.

10.2 Economic Context

During 2011/12 the Monetary Policy Committee (MPC) was focused on helping the economy to recover, but against a backdrop of inflation remaining above it's target level.

Despite keeping Bank Rate at an unprecedented historical low of 0.5% all year, the MPC increased the level of quantitative easing from £200bn to £325bn.

The dominant focus in 2011/12 was on quarterly GDP growth figures. Whilst there was modest growth in Quarters 2 and 3 in 2011 the economy disappointed in quarter 4 by contracting by 0.3% and that was followed up by a first estimate for Q1 2012 of contracting by 0.3% to leave the economy flat on the year and push the UK technically back into recession.

Inflation has been a major concern of the MPC as CPI increased to 5.2% in September 2011 before falling gradually to end the year at 3.5% and has remained above the 2% target level for CPI by more than 1% for the whole of 2011/12.

10.3 Borrowing and Investment Rates in 2011/12

PWLB borrowing rates at the beginning and end of the year were:

Loan Period	*31 March 2011*	*30 March 2012*
1 year	1.89%	1.28%
25 year	5.31%	4.32%
50 year	5.24%	4.36%

The overnight investment rate has varied little during the year (under 0.5%). The 3 month investment rate has increased gradually throughout the year to stand at 1.00% at year end.

10.4 Treasury Borrowing and Rescheduling

The borrowing strategy for the current year has been to take a pragmatic approach to the use of PWLB borrowing, spreading interest rate risk and taking advantage of rate movements when appropriate.

A summary of the transactions for the year is shown below. During the year 2 PWLB loans matured, one in May for £5m and one in November for £10m. In August we took a 3 year Maturity PWLB loan to replace the maturing loans during the year to take advantage of the attractive interest rates:

Date	Action	Amount £m	Interest Rate
09/08/11	PWLB – 3 yrs Maturity	10.000	1.92%

Short-term borrowing has also been used throughout the year to take advantage of favourable interest rates.

10.5 **PWLB Repayments & Discounts**
No loans were repaid early or rescheduled during the year.

10.6 **LOBO Loans**
The Council has £60m LOBO (Lender's Option Borrower's Option) loans within its overall debt portfolio. LOBOs give the lender the right to "call" the loan at pre-determined dates and request a change in interest rate; at this point the borrower (i.e. the Council) can accept the revised terms or reject them and repay the loan. There were no LOBO's "called" during 2011/12 although they represent a significant exposure when interest rates eventually start to increase making calls more likely.

10.7 **Maturity Structure of Debt**
An analysis of the maturity structure of our debt is shown below.

Analysis of Debt Maturity as at 31st March:

	2012 £'000	%	**2011 £'000**	%
Maturing in less than 1 year	37,148	25.2	24,382	18.6
Maturing in 1-2 years	11,001	7.4	6,001	4.6
Maturing in 2-5 years	13,002	8.8	13,002	9.9
Maturing in 5-10 years	3,505	3.5	4,505	3.5
Maturing in more than 10 years	83,014	56.2	83,015	63.4
	147,670	100.0	**130,905**	100.0

10.8 **Debt Performance**
As highlighted in section 8 the average debt portfolio rate has fallen over the course of the year from 3.60% to 3.41%. This is due to active management and the low interest rates that have prevailed throughout the year.

11. 2011/12 INVESTMENTS

11.1 **Strategy**
The strategy for the year was to gain maximum benefit, subject to risk control parameters, whilst achieving as a minimum the 7 day deposit rate. The authority manages all of its investments in-house and invests with the institutions complying with its counterparty limits and credit ratings. Some investments are short term related to cash flows and others include longer term investment instruments that benefited returns in 2011/12.

11.2 **2011/12 Performance**
Detailed below are the results of the investment strategy undertaken by the Council, based on the average investment during the year.

	Average Investment	**Rate of Return (gross of fees)**	**Rate of Return (net of fees)**	**Benchmark Return ***
Investments	£73.912m	3.46%	3.46%	0.52%

No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year.

At the beginning of the year the Council had an investment of £5m with Dexia Bank Plc in its investment portfolio. This banking group came under significant financial pressure due to its exposure to Greek debt and after closely monitoring the situation for sometime, premature repayment of the investment was requested in late Summer as the economic situation worsened. Repayment was agreed with no penalty and no loss of accrued interest.

12. **SHROPSHIRE COUNCIL DEBT**

The Council makes an annual contribution (£2.044m in 2011/12) towards County Council costs on pre disaggregation debt (i.e. pre unitary inception) - interest paid averaged 5.14% last year. The rate of interest paid on this is managed by Shropshire and is considerably higher than the rate payable by Telford & Wrekin Council on it's borrowing.

13. **OVERALL OUTTURN FOR 2011/12**

The net overall position is summarised in the table below. The sound overall position has resulted from a mix of cash flow benefits plus pro-active treasury management activities. The budget reflected the position when the budget was set. The underspend has been achieved from the impact of the reductions to the capital programme made as part of the 100 day review of the 2011/12 financial strategy (reported to Full Council in November 2011) together with active management of debt principal and the low interest rates prevailing for the year. Overall a net saving of just under £0.5m was made against budget for the year.

Summary of Outturn Position	Estimate £m	Outturn £m	Variance £m
Interest Received	(2.752)	(2.445)	0.307
Principal Repayments & Debt Management Costs	5.952	5.532	(0.420)
Interest Paid	5.899	5.516	(0.383)
Net Position	9.099	8.603	(0.496)

14. **COMPLIANCE WITH TREASURY LIMITS**

During the financial year the Council operated within the Treasury Limits and Prudential Indicators set out in the Council's Treasury Policy Statement and annual Treasury Strategy Statement at all times. The outturn for the Prudential Indicators are detailed in Appendix 1 which shows that no limits were breached during the year.

15 **LEASING**

Each year the Council arranges operating leases for assets such as vehicles, computers and equipment. This helps spread the cost over a number of years in line with the anticipated life of the equipment.

The first drawdown for 2011/12 took place in October 2011 for ICT equipment and vehicles. The value of the lease was £0.564m with JCB Finance. The final drawdown for 2011/12 was completed in March

2012. This drawdown from JCB Finance totalled £0.024m and funded the purchase of Golf Course Maintenance Equipment over five years at an interest rate of 1.95%.

16. 2012/13 UPDATE

The remainder of this report deals with the current financial year based largely on information to 31 May 2012.

16.1 Strategy

In the current economic climate, the strategy for the next few months is to review investment opportunities as they arise. We will review borrowing opportunities as we progress through the year and look to take advantage of the advantageous interest rates where possible. Maturing investments will also be used to reduce the need to borrow where possible.

16.2 Interest Rates

Base rate began the year at 0.5% and has remained there. The current expectation is that there will be no increase before June 2015.

16.3 Prudential Regime

This Council agreed its required indicators at Council on 1 March 2012. There have been no breaches of the indicators and none have been amended. The Council set itself an Operational limit for external debt of £210m for 2012/13 and an Authorised limit of £230m. Our total borrowing outstanding is £138m which is well within both limits.

16.4. Borrowing

The loan in the table below matured during 2012/13 to-date. Up to 31/5/12 no new long term borrowing has been undertaken this year to date. As at 31 May 2011 temporary borrowing stood at £26.3m.

Date	Action	Amount £m	Impact on budget
01/05/12	Matured – 3.38% loan	5	None

16.5. Internally Managed Investments

The strategy for the year is to gain maximum benefit at minimum risk whilst achieving as a minimum, the 7 day deposit rate. For the period to 31 May 2012 some £267m worth of investments have been made in our overnight call accounts. Rates have ranged from 0.35% to 0.80%. As at 31 May 2012 investments stood at £63.15m.

Potentially the Council can place up to £20.0m with any Counterparty. At the end of May the greatest exposure with a single counterparty was £20.0m with Barclays (31.7% of the portfolio). We currently have no investments with non UK sovereigns. A detailed breakdown is shown in Appendix 2.

Since the setting of our Counterparty Limits and lending criteria for 2012/13 in March the Rating Agencies have amended their ratings and the Individual Ratings that formed part of our lending criteria have been replaced by viability ratings. As a result we will no longer be using individual ratings when assessing counterparties. We will continue to be guided as to which counterparties to use by Arlingclose our Treasury Advisors who take all the rating information together with other information when assessing which counterparties to use and the duration of any new investments placed.

17 **Background Papers**

CIPFA Code of Practice for Treasury Management in Local Authorities
Fund Manager Valuations
Temporary Borrowing records
PWLB records
Investment records

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PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2010/11	2011/12	2011/12
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	**£m**	**£m**	**£m**
	Actual Outturn	**Original Estimate**	**Actual Outturn**
Capital Expenditure			
TOTAL	74.7	105.5	71.7
Ratio of financing costs to net revenue stream			
General fund	2.18%	2.60%	2.35%
Net borrowing requirement			
brought forward 1 April	123.076	161.412	130.905
carried forward 31 March	130.905	214.583	147.670
in year borrowing requirement	7.829	53.171	16.765
Capital Financing Requirement as at 31 March *subject to final accounts			
TOTAL	228.899	284.390	248.515*
Annual change in Cap. Financing Requirement			
TOTAL	23.286	46.453	21.228
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum (not cumulative)	6.47	4.04	4.04

PRUDENTIAL INDICATOR	2010/11	2011/12	2011/12
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£m**	**£m**	**£m**
	final	**original**	**final**
Authorised limit for external debt -			
borrowing	300	330	330
other long term liabilities	6	6	6
TOTAL	306	336	336
Operational boundary for external debt -			
borrowing	280	310	310
other long term liabilities	4	4	4
TOTAL	284	314	314
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	190	190	190
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments:-	80%	60%	60%
Upper limit for total principal sums invested for over 364 days (per maturity date)	80%	95%	95%

Maturity structure of fixed rate borrowing during 2010/11	lower limit	upper limit
under 12 months	0%	20%
12 months and within 24 months	0%	25%
24 months and within 5 years	0%	50%
5 years and within 10 years	0%	75%
10 years and above	25%	100%

Appendix 2

Summary of Investments at 31 May 2012

	Sovereign Credit Rating	Individual Credit Rating	Total £m	%
Call Accounts				
HSBC	UK AAA	F1+ AA Support 1	4.150	
RBS	UK AAA	F1 A Support 1	4.000	
Santander	UK AAA	F1 A+ Support 1	5.000	
			13.150	**21**
Fixed Deposits				
Barclays	UK AAA	F1 A Support 1	20.000	
Lloyds TSB	UK AAA	F1 A Support 1	15.000	
RBS	UK AAA	F1 A Support 1	5.000	
			40.000	**63**
Variable Deposit				
RBS	UK AAA	F1 A Support 1	10.000	16
			10.000	**16**
Total			**63.150**	**100**