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Item 8

ANNUAL TREASURY MANAGEMENT OUTTURN REPORT 2010/11

EXECUTIVE MEMBER: Councillor Elaine Woodburn
LEAD OFFICER: Joanne Wagstaffe, Director for Resources & Transformation
REPORT AUTHOR: Leanne Barwise – Senior Accounting Officer

WHY HAS THIS REPORT COME TO THE EXECUTIVE?
(eg Key Decision, Policy recommendation for Full Council, at request of Council,etc.)

The 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).

During 2010/11 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 02/03/2010)
- a mid-year (minimum) treasury update report (Council 18/11/2010)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition, it was agreed that this Council would receive a quarterly treasury management update report, the first of which was presented at Executive on 09/02/2011. An update report will be produced each quarter of the 2011/12 financial year.

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.

This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to the Full Council. Member training on treasury management issues was undertaken during the year on 04/02/2011 in order to support Members' scrutiny role.

RECOMMENDATIONS:

The Executive are recommended to:
(i) Approve the actual 2010/11 prudential and treasury indicators in this report
(ii) Note the annual treasury management report for 2010/11

1. INTRODUCTION

This report summarises:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

2. THE COUNCILS CAPITAL EXPENDITURE & FINANCING 2010/11

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.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

PRUDENTIAL INDICATOR 1 (£m)	2009/10 Actual	2010/11 Estimate	2010/11 Actual
Total capital expenditure	**6.21**	**5.26**	**3.38**
Resourced by:			
• Capital receipts	1.78	2.62	1.66
• Capital grants	4.34	2.61	1.54
• Capital reserves	0.09	0	0
• Revenue	0	0.03	0.18
Unfinanced capital expenditure	**0**	**0**	**0**

3. THE COUNCILS OVERALL BORROWING NEED

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2010/11 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2010/11 MRP Policy (as required by CLG Guidance) was approved by Council as part of the Treasury Management Strategy Report for 2010/11 on 02/03/2010.

The Council's CFR for the year is shown below, and represents a key prudential indicator. This includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

PRUDENTIAL INDICATOR 2 CFR (£m)	31 March 2010 Restated	31 March 2011 Original Indicator	31 March 2011 Actual
Pre Adjustment Opening Balance	11.42	0	11.09
A Factor Adjustment	(1.70)	(1.70)	(1.70)
Adjusted Opening balance	9.72	0	9.39
Add unfinanced capital expenditure (as above)	0	1	0
Add adjustment for the inclusion of on-balance sheet PFI	0	0	0
Less MRP	0	0	0
Less PFI & finance lease repayments	(0.33)	(0.05)	(0.37)
Adjusted Closing balance	9.39	0.95	9.02

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Net borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term, the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2010/11 plus the expected changes to the CFR over 2011/12 and 2012/13. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2010/11. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

PRUDENTIAL INDICATOR 3	31 March 2010 Actual	31 March 2011 Original	31 March 2011 Actual
Net borrowing position	(£14.56m)	(£7.94m)	(£13.92m)
CFR	£9.39m	£0.95m	£9.01m

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2010/11 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

PRUDENTIAL INDICATOR 4	2010/11
Authorised limit	£17.00m
Maximum gross borrowing position	£12.59m
Operational boundary	£12.00m
Average gross borrowing position	£12.41m
Financing costs as a proportion of net revenue stream	0%

4. TREASURY POSITION AS AT 31 MARCH 2011

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. At the beginning and the end of 2010/11 the Council's treasury position was as follows:

TABLE 1	31 March 2011 Principal	Rate/ Return	Average Life yrs	31 March 2010 Principal Restated	Rate/ Return	Average Life yrs
Fixed rate funding:	£5m	7.55%	31	£5m	7.55%	32
Variable rate funding:	£0m	0%		£0m	0%	
Total debt	***£5m***	*7.55%*		***£5m***	*7.55%*	
CFR	***£9.01m***			***£9.40m***		
Less PFI Liability	***(£6.62m)***			***(£6.87m)***		
Less Vehicle Leases	***(£0.60m)***			***(£0.72m)***		
Actual Borrowing	***(£5.00m)***			***(£5.00m)***		
Over/ (under) borrowing	***£3.21m***			***£3.19m***		
Total investments	*(£18.92m)*	*1.12%*		*(£19.56m)*	*0.75%*	

All investments within the Councils portfolio were placed for less than one year.

The exposure to fixed and variable rates were as follows:

NET DEBT	31 March 2010 Actual	2010/11 Original Limits	31 March 2011 Actual
Fixed rate (principal)	(£12.50m)	£5.10m	(£5.00m)
Variable rate (principal)	(£2.06m)	£5.10m	(£8.92m)

5. THE STRATEGY FOR 2010/11

Within the 2010/11 financial year the shorter-term interest rates, on which investment decisions are based, were likely to remain subdued for some time. This together with a combination of counterparty risk and lack of value in longer term deposit rates, this Authority agreed the continuation of an investment policy of maintaining shorter term, high quality investments and took a cautious approach to its 2010/11 treasury strategy.

It is currently difficult to have confidence as to exactly how strong the UK economic recovery is likely to be. There are huge uncertainties in all forecasts. Counterparty risk should become more subdued and with the expectation of an increasing Bank Rate, value will begin to return to longer term investments. If there is clear evidence of this taking place, an amendment to the investment strategy to cautiously extend investments may be considered.

6. 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.

Chart 1: Bank Rate v LIBID investment rates

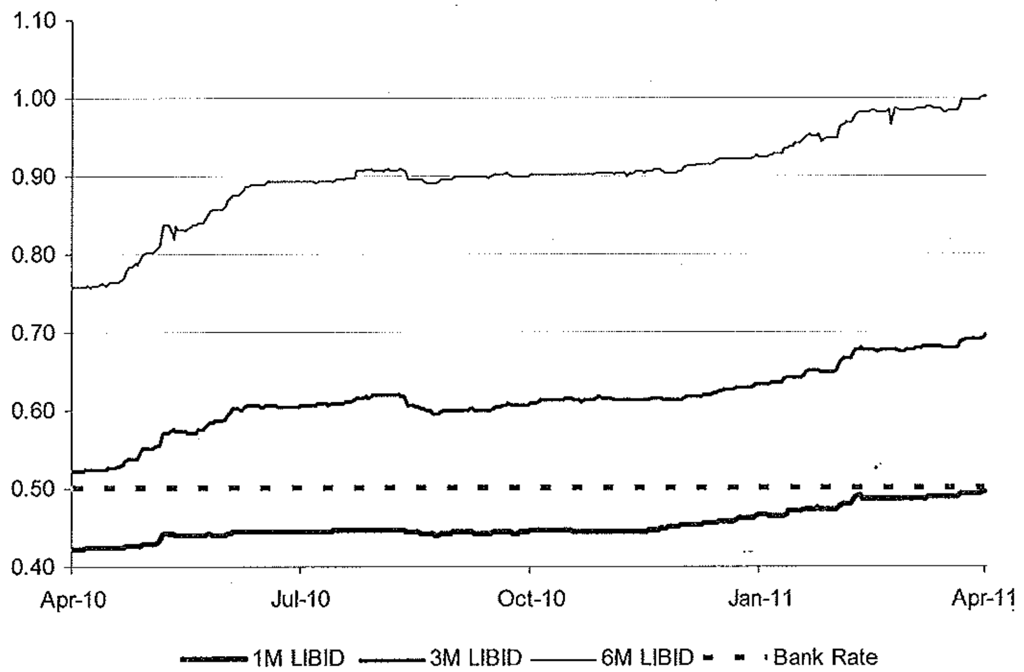
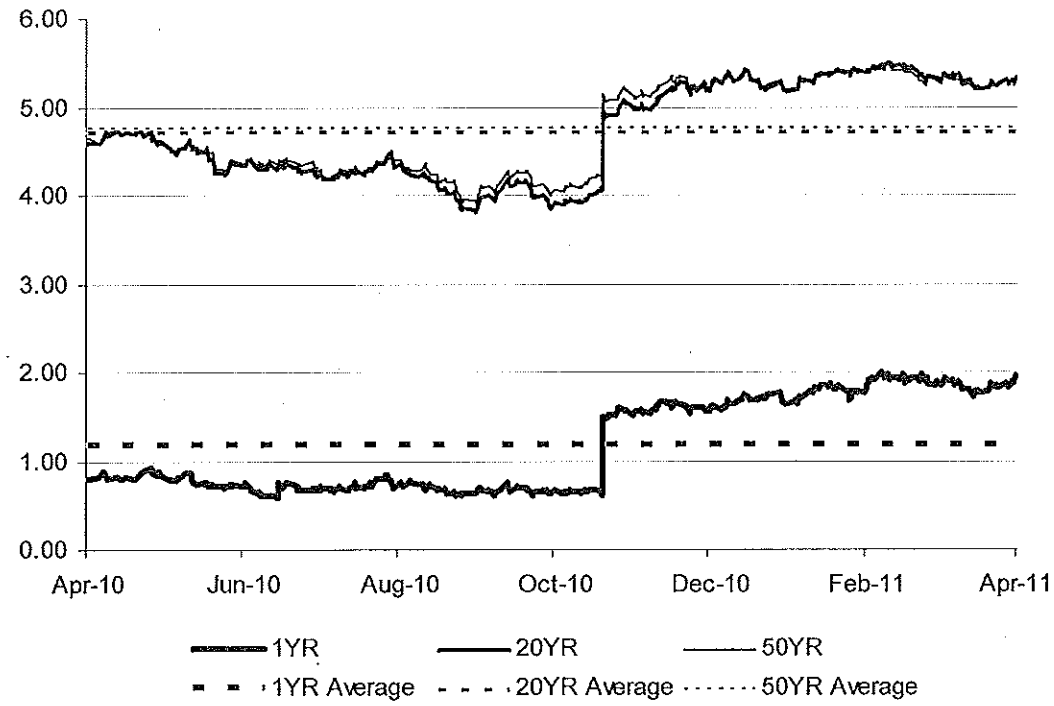


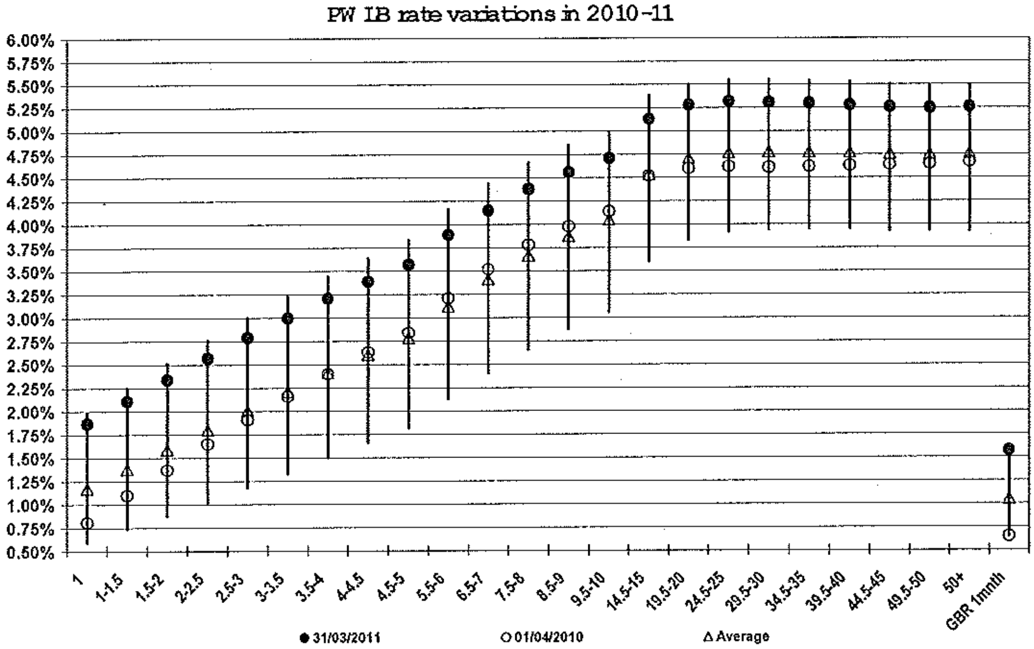
Chart 2: Average v new borrowing rates



7. BORROWING RATES IN 2010/11

PWLB borrowing rates - the graph and table for PWLB maturity rates below show, for a selection of maturity periods, the range (high and low points) in rates, the average rates and individual rates at the start and the end of the financial year.

Variations in most PWLB rates have been distorted by the October 2010 decision by the PWLB to raise it borrowing rates by about 0.75 – 0.85% e.g. if it had not been for this change, the 25 year PWLB at 31 March 2011 (5.32%) would have been only marginally higher than the position at 1 April 2010.



PWLB BORROWING RATES 2010/11 for 1 to 50 years

	1	1.5-2	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1 month variable
01/04/2010	0.810%	1.370%	1.910%	2.400%	2.840%	4.140%	4.620%	4.650%	0.650%
31/03/2011	1.870%	2.340%	2.790%	3.210%	3.570%	4.710%	5.320%	5.250%	1.570%
HIGH	1.990%	2.510%	3.000%	3.440%	3.830%	4.990%	5.550%	5.480%	1.570%
LOW	0.600%	0.880%	1.180%	1.500%	1.820%	3.060%	3.920%	3.930%	0.650%
Average	1.177%	1.590%	2.009%	2.413%	2.788%	4.050%	4.771%	4.756%	1.052%
Spread	1.390%	1.630%	1.820%	1.940%	2.010%	1.930%	1.630%	1.550%	0.920%
High date	07/02/2011	07/02/2011	07/02/2011	07/02/2011	09/02/2011	09/02/2011	09/02/2011	09/02/2011	07/03/2011
Low date	15/06/2010	12/10/2010	12/10/2010	12/10/2010	12/10/2010	31/08/2010	31/08/2010	31/08/2010	01/04/2010

8. BORROWING OUTTURN FOR 2010/11

Treasury Borrowing

Borrowing – No additional loans were drawn in the year. The council still has one remaining market loan in our portfolio which is summarised below:-

Lender	Principal	Type	Interest Rate	Maturity
Market	£5.0m	Fixed interest rate	7.55%	31 Years

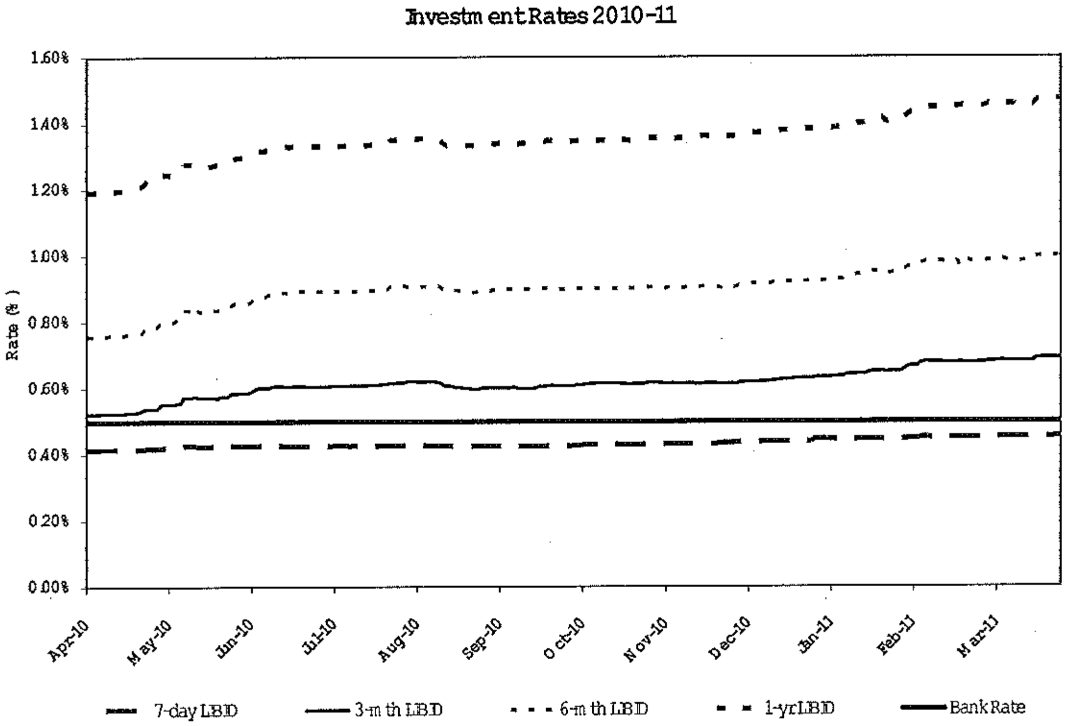
We continually assess the position of this loan with our Treasury Consultants, Sector, to see whether we are securing the best terms for the Council. At the current time the advice is to leave this loan in its present form, as the penalty for repaying early would be prohibitive.

9. INVESTMENT RATES IN 2010/11

The tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in the shorter term deposit rates. 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 saw 6 and 12 month rates picking up.

Overlaying the relatively poor investment returns was the continued counterparty concerns, most evident in 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 highlighted the ongoing need for caution in treasury investment activity.

	Overnight	7 Day	1 Month	3 Month	6 Month	1 Year
01/04/2010	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
31/03/2011	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
High	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
Low	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
Average	0.43%	0.43%	0.45%	0.61%	0.90%	1.35%
Spread	0.03%	0.04%	0.07%	0.17%	0.24%	0.28%
High date	31/12/2010	30/03/2011	31/03/2011	31/03/2011	31/03/2011	31/03/2011
Low date	01/04/2010	01/04/2010	01/04/2010	01/04/2010	01/04/2010	01/04/2010



10. INVESTMENT OUTTURN FOR 2010/11

Investment Policy – the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Executive on 16th February 2010. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources (£m)	31 March 2010 Restated	31 March 2011
Balances	3.6	3.3
Earmarked reserves	7.4	6.3
Provisions	0.1	0.2
Usable capital receipts	5.4	4.2
Total	16.5	14.3

Investments held by the Council - the Council maintained an average balance of £25.67m of internally managed funds. The internally managed funds earned an average rate of return of 0.89%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.43%. This compares with a budget assumption of £26.78m investment balances earning an average rate of 1.5%.

As at 31st March 2011, the Council's portfolio consisted of 100% use of specified investments, this compares to a limit of 75% which was applied to the use of Non-Specified investments.

Additionally during the year, we made use of the Security, Liquidity, Yield (SLY) model provided by our Treasury Consultants, Sector. As a result, we identified that the authority is very low risk. We will continue to review the position to assess whether better investment returns could be achieved whilst still retaining an acceptable level of risk as outlined in the Treasury Management Strategy Statement.

12. CONCLUSIONS

The Council has complied with all of the relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its 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.

13. STATUTORY OFFICER COMMENTS

13.1 The Monitoring Officer's comments are: No comments on this report

13.2 The Section 151 Officer's comments are: No further comments on this report

13.3 Other consultee comments, if any:

14. HOW WILL THE PROPOSALS BE PROJECT MANAGED AND HOW ARE THE RISKS GOING TO BE MANAGED?

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 2009/10);
- 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 CLG 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 8th November 2007

List of Appendices

Appendix A – Temporary Investments as at 31/03/2011

List of Background Documents:

Annual report on the Treasury Management Service and Actual Prudential Indicators 2009/10, Treasury Management Strategy 2010/11 & 2011/12, Mid Year Treasury Management Report 2010/11

APPENDIX A

TEMPORARY INVESTMENTS AT 31/03/2011

	AMOUNT	PERIOD OF LOAN	VALUE DATE	MATURITY DATE	RATE	BASE RATE
NATWEST	27,268	CURRENT				
BANK OF SCOTLAND	733,707	CALL			0.75%	
RBS MMF	1,407,000	CALL			0.60%	
BARCLAYS	3,246,000	CALL			0.75%	
RBS 1	501,337	28 Day Notice	09/03/2011	27/04/2011	0.80%	
RBS 2	1,000,210	60 Day Notice	22/03/2011	23/05/2011	0.85%	
RBS 3	2,001,529	90 Day Notice	25/01/2011	26/04/2011	0.90%	
LLOYDS DEPOSIT	1,000,000	3 MONTHS	17/01/2011	18/04/2011	1.12%	
BANK OF SCOTLAND	1,000,000	364 DAYS	15/02/2011	14/02/2012	2.05%	
LLOYDS DEPOSIT	3,000,000	364 DAYS	16/02/2011	15/02/2012	2.10%	
LLOYDS DEPOSIT	1,000,000	3 MONTHS	16/02/2011	16/05/2011	1.21%	
SANTANDER	2,000,000	1 MONTH	09/03/2011	27/04/2011	0.90%	
SANTANDER	1,500,000	2 MONTH	28/03/2011	19/05/2011	0.90%	
SANTANDER	500,000	2 MONTH	28/03/2011	13/05/2011	0.90%	
TOTAL	**18,917,050**				1.12%	0.50%