

**TREASURY MANAGEMENT OUT-TURN 2011/12**

**EXECUTIVE MEMBER:** Councillor Gillian Troughton  
**LEAD OFFICER:** Joanne Wagstaffe, Director for Resources & Transformation  
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**Why has this report come to Full Council?**

The Council is required by regulations issued under the Local Government Act 2003 to produce an annual review of treasury management activities and the actual prudential and treasury indicators for 2011/12. This report meets the requirements of the CIPFA Code of Practice for Treasury Management (The Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code). As detailed in our Treasury Management Strategy and as required under The Code, this report has to be considered by the Audit Committee before being recommended to Full Council. This report will be considered by Audit Committee on 20<sup>th</sup> June 2012 and it is recommended that Audit Committee be delegated authority to fully approve the out-turn.

**Recommendations:**

Full Council are recommended to:

- (i) Approve the actual 2011/12 prudential and treasury indicators attached at Appendix A
- (ii) Note the Treasury Management Out-turn 2011/12 detailed in Section 8 of this report
- (iii) Note the make-up of the portfolio of investments as at 31<sup>st</sup> March 2012 attached at Appendix B
- (iv) Note that this report will be formally considered by the Audit Committee on 20<sup>th</sup> June and delegate authority to the committee to approve the out-turn.

**1. Introduction**

During 2011/12 the following reports were presented to the individual committee as detailed:

- the annual Treasury Strategy in advance of the year (Audit 4<sup>th</sup> February 2011 & Council 22<sup>nd</sup> February 2011)
- urgent amendment to the Treasury Strategy in light of the heightened uncertainty in financial markets (Council 13<sup>th</sup> October 2011 & Audit 3<sup>rd</sup> November 2011)
- a mid-year treasury update report (Executive 22<sup>nd</sup> November 2011)

- a quarterly update report (Executive August 2011, November 2011 and February 2012)
- an annual report following the year which describes the activity compared to the strategy (this report)

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 the reports by the Audit Committee before being reported to Full Council (wherever possible). This report will be formally considered by Audit Committee on 20<sup>th</sup> June 2012.

Member training on treasury management issues was undertaken prior to the start of the 11/12 financial year on 04/02/2011 in order to support Members' scrutiny role. Another training session will be arranged for the 2012/13 financial year as part of the ongoing Treasury Management training program for Members and Officers.

## **2. The Economy and Interest Rates**

The financial year 2011/12 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2011-12 was that Bank Rate would start gently rising from quarter 4 2011. However, GDP growth in the UK was disappointing during the year under the weight of the UK austerity programme, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the EU. The EU sovereign debt crisis grew in intensity during the year until February when a second bailout package was eventually agreed for Greece. 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% but then fell to 3.4% in February, with further falls expected to below 2% over the next two years.

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.

### **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.

### 3. Overall Treasury Position as at 31<sup>st</sup> March 2012

At the beginning and the end of 2011/12 the Council's treasury position was as follows:

|  | 31 <sup>st</sup> March<br>2011<br>Principal | Rate/<br>Return | Average<br>Life<br>(Years) | 31 <sup>st</sup> March<br>2012<br>Principal | Rate/<br>Return | Average<br>Life<br>(Years) |
|--|---|-----------------|----------------------------|---|-----------------|----------------------------|
| <b>Total debt<br/>(Fixed rate funding)</b> | <b>£5.00m</b>                               | <b>7.55%</b>    | <b>31</b>                  | <b>£5.00m</b>                               | <b>7.55%</b>    | <b>30</b>                  |
| CFR  | £8.81m                                      |                 |                            | £8.42m                                      |                 |                            |
| Less PFI Liability                         | (£6.62m)                                    |                 |                            | (£6.38m)                                    |                 |                            |
| Less Vehicle Leases                        | (£0.60m)                                    |                 |                            | (£0.45m)                                    |                 |                            |
| A Factor Adjustment                        | £1.59m                                      |                 |                            | £1.59m                                      |                 |                            |
| Over / (under)<br>borrowing                | £3.41m                                      |                 |                            | £3.41m                                      |                 |                            |
| Total investments                          | £18.86m                                     | 1.12%           |                            | £18.92m                                     | 1.39%           |                            |
| Net debt                                   | (£6.64m)                                    |                 |                            | (£7.09m)                                    |                 |                            |

The balance and rates quoted in the total investment row in the table above are not representative of a full year. They detail the principal outstanding at 31<sup>st</sup> March 2011 and 31<sup>st</sup> March 2012 respectively and the average rate of return on those outstanding investments, at the same dates.

### 4. The Strategy for 2011/12

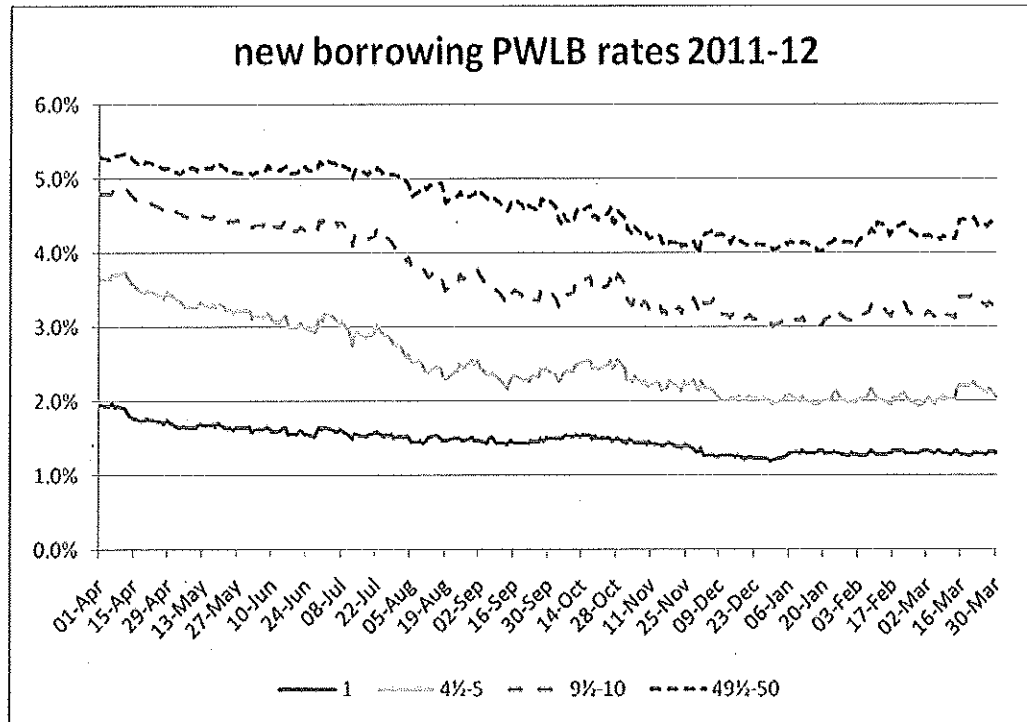
In light of the heightened uncertainty in the financial markets, and following advice from our Treasury Advisors, Sector, we reviewed the original Treasury Management Strategy that was approved by Council on 22<sup>nd</sup> February 2011. The amendment was presented and approved by Council on 13<sup>th</sup> October 2011 and formed part of the daily operation of Treasury Management with immediate effect.

The revised strategy placed additional restrictions on our investment criteria and we utilised "safe havens" being UK semi-nationalised institutions (RBS & Lloyds/BOS Group) and opened additional Money Market Funds (highly rated liquid institutions) or instant access accounts with Banks in lieu of placing investments with Building Societies or lower rated counterparties. This ensured there was a balance between security and liquidity of funds and the yield achieved, with security being the principle concern particularly in the current economic climate.

The interest rates were anticipated to be low for the year but with a rising Bank Rate (starting in quarter 4 of 2011) and similar gradual rises in medium and longer term fixed borrowing rates over 2011/12. Variable or short-term rates were expected to be the cheaper form of borrowing over the period if required, although we had no need to borrow. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

## 5. Borrowing Rates in 2011/12

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



## 6. Borrowing Outturn for 2011/12

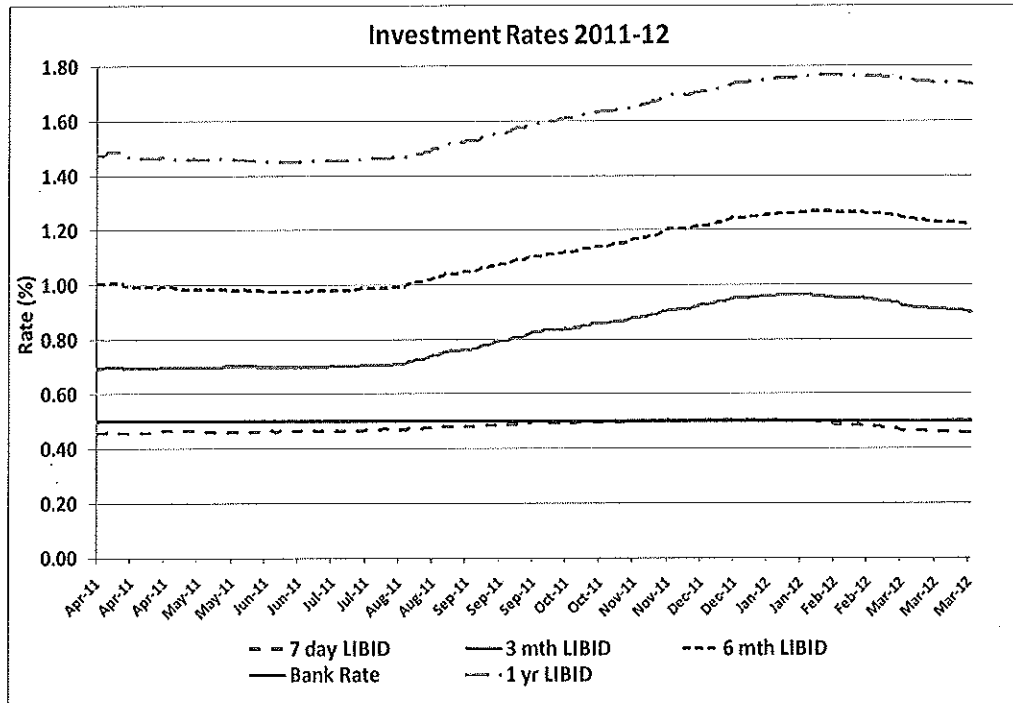
**Borrowing** – The Council only has one remaining market loan in its debt portfolio as detailed below. We continually assess the position of this loan with our Treasury Consultants, Sector, to ensure we are securing the best terms for the Council. At the current time, the advice is to leave the loan in its present form, as the penalty for repaying early would be prohibitive.

| Lender | Principal | Date Advanced | Type                | Interest Rate | Maturity | Date of Maturity |
|--------|-----------|---------------|---------------------|---------------|----------|------------------|
| Market | £5.00m    | 01/02/2002    | Fixed interest rate | 7.55%         | 30 years | 01/02/2042       |

## 7. Investment Rates in 2011/12

The tight monetary conditions following the 2008 financial crisis continued through 2011/12 with little material movement in the shorter term deposit rates. However, one month and longer rates rose significantly in the second half of the year as the Eurozone crisis grew. Bank Rate remained at its historic low of 0.5% throughout the year while market expectations of the imminence of monetary tightening were gradually pushed further and further back during the year to the second half of 2013 at the earliest.

Overlaying the relatively poor investment returns were the continued counterparty concerns generated by the Eurozone sovereign debt crisis.



## 8. Investment Outturn for 2011/12

**Investment Policy** – the Council’s investment policy is governed by CLG guidance, which was implemented in the annual investment strategy approved by the Council on 22<sup>nd</sup> February 2011 and then updated due to the heightened uncertainty in the financial markets on 13<sup>th</sup> October 2011. 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). Operationally, however, within the strategy we have temporarily restricted the use of Building Societies and other lower rated institutions and ensured funds are only placed with semi-nationalised institutions, higher rated banks or Money Market Funds and instant access accounts.

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

**Investments held by the Council** - Over the full financial year, the Council maintained an average balance of £24.7m of internally managed funds. The actual interest earned for 2011/12 was £267,565 (as reported in the Revenue Out-turn Report) against a budgeted return of £252,822, resulting in a net improvement against the budgeted return on investments for 2011/12 of £14,743. This compares to actual interest earned in 2010/11 of £227,893 against a budget estimate of £401,749, resulting in a shortfall for 2010/11 of £173,856.

The actual interest rate received over the period 2010/11 to 2011/12 has improved by £39,672 whilst bank base rates have stayed the same at 0.5%. This reflects the changes in the Treasury Management Investment Strategy implemented during the year.

The internally managed funds earned an average rate of return of 1.08% over the 2011/12 financial year. The comparable performance indicator is the average 7-day 2011/12 LIBID rate which was 0.48%. This compares with a 2011/12 budget assumption of £25m investment balances earning an assumed interest rate of approximately 1% and additionally an average rate of return achieved in 2010/11 of 0.89%.

## **9. Conclusion**

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.

## **10. Statutory Officer Comments**

10.1 The Monitoring Officer's comments are: No additional comments

10.2 The Section 151 Officer's comments are: Included within the report

10.3 Other consultee comments, if any: None at this stage

10.4 EIA comments: Completed as part of budget setting process

## **11. 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;
- 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.

**List of Appendices**

Appendix A – Prudential & Treasury Indicators

Appendix B - Temporary Investments as at 31/03/2012

**List of Background Documents:** Treasury Management Strategy 2011/12, Mid-Year Treasury Management Report 2011/12, Capital Programme 11/12 – Outturn Report

## Appendix A

### Capital Prudential and Treasury Indicators

The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, reflecting the outcome of the Council's underlying capital appraisal systems.

During 2011/12, this Council has complied with its legislative and regulatory requirements i.e. the Capital Prudential Indicators that were set at Full Council within the Treasury Management Strategy 2011/12 on 22<sup>nd</sup> February 2011. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

- A. **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 2011/12 plus the expected changes to the CFR over 2011/12 and 2012/13 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2011/12. *The Council has complied with this indicator as detailed within Table A overleaf.*
- B. **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. *Table B demonstrates that during 2011/12 the Council has maintained gross borrowing within our authorised limit.*
- C. **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. *See Table B for the 2011/12 out turn position of the operational boundary.*
- D. **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.



**Table A**

| Actual prudential and treasury indicators | Ref   | 2010/11 Actual £m | 2011/12 Original Estimate £m | 2011/12 Actual £m |
|---|-------|-------------------|------------------------------|-------------------|
| Capital expenditure                       |       | £3.35m            | £5.00m                       | £1.68m            |
| Capital Financing Requirement             |       | £8.81m            | £8.42m                       | £8.42m            |
| External debt                             | (a)   | £12.22m           | £11.83m                      | £11.83m           |
| Investments - Under 1 year                | (b)   | £18.86m           | £16.45m                      | £18.92m           |
| Net borrowing                             | (a-b) | (£6.64m)          | (£4.62m)                     | (£7.09m)          |

**Table B**

| Prudential Indicator                                  | 2011/12 |
|---|---------|
| Authorised limit                                      | £17.00m |
| Maximum gross borrowing position                      | £12.22m |
| Operational boundary                                  | £12.00m |
| Average gross borrowing position                      | £12.02m |
| Financing costs as a proportion of net revenue stream | 3.34%   |

#### **Affordability Prudential Indicators**

The previous tables cover the overall capital and control of borrowing prudential indicators, but we are also required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

The indicator detailed in Table C below, identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

**Table C**

| Ratio of financing costs to net revenue stream | 31 March 2011 Actual | 2011/12 Original Limits | 31 March 2012 Actual |
|--|----------------------|-------------------------|----------------------|
|  | 2%                   | 3.37%                   | 3.34%                |

The next indicator as detailed in Table D (overleaf) identifies the revenue costs associated with proposed changes to the three year capital programme recommended at Full Council on 22<sup>nd</sup> February 2011 compared to the Council's existing approved commitments and current plans.

**Table D**

| <b>Incremental impact of capital investment decisions</b> | <b>31 March 2011 Actual</b> | <b>2011/12 Original Limits</b> | <b>31 March 2012 Actual</b> |
|---|-----------------------------|--------------------------------|-----------------------------|
| Increase in Council Tax (Band D) per annum                | 0%                          | 0%                             | 0%                          |

The maturity structure of the debt portfolio was as follows:

|                              | <b>31 March 2011 Actual</b> | <b>2011/12 Original Limits</b> | <b>31 March 2012 Actual *</b> |
|------------------------------|-----------------------------|--------------------------------|-------------------------------|
| Under 12 months              | -                           | -                              | 100%                          |
| 12 months and within 5 years | -                           | -                              | 100%                          |
| 5 years and within 10 years  | -                           | -                              | 100%                          |
| 10 years and within 20 years | -                           | -                              | 100%                          |
| 20 years and within 30 years | -                           | -                              | 100%                          |
| 30 years and within 40 years | 100%                        | 100%                           | 100%                          |
| 40 years and above           | -                           | -                              | 100%                          |

\*This Indicator has changed from last year due to a change in 2011 guidance notes in relation to the "call date" of our £5m LOBO (lenders option, borrower's option) loan. In basic terms, the borrower has the right to request that the principal is repaid upon the date that the interest is repaid, which for Copeland is twice yearly. This is reflected by 100% maturity indicated in every category above. The likelihood of this happening is minimal given the rate of return that we are currently obligated to pay. Additionally, if there are any changes to the current loan agreement, we have the opportunity to repay the principal without any penalties, which would not be financially beneficial to the loan company.

All investments within the Councils portfolio were placed for under one year. The authority held 100% specified investments at the year-end against a maximum limit of 75% non-specified investments.

The exposure to fixed and variable rate investments was as follows:

|                           | <b>31 March 2011 Actual</b> | <b>31 March 2012 Actual</b> |
|---------------------------|-----------------------------|-----------------------------|
| Fixed rate (Principal)    | £10.00m                     | £7.50m                      |
| Variable rate (Principal) | £8.86m                      | £11.42m                     |
| <b>TOTAL INVESTMENT</b>   | <b>£18.86m</b>              | <b>£18.92m</b>              |

Appendix B

TEMPORARY INVESTMENTS AT 31/03/12

|                | AMOUNT            | PERIOD OF LOAN | VALUE DATE | MATURITY DATE | RATE  | BASE RATE |
|----------------|-------------------|----------------|------------|---------------|-------|-----------|
| BARCLAYS       | 991,000           | CALL           |            |               | 0.75% |           |
| RBS CALL       | 4,484,000         | CALL           |            |               | 0.80% |           |
| RBS MMIF       | 1,447,000         | CALL           |            |               | 0.73% |           |
| IGNIS MMIF     | 4,500,000         | CALL           |            |               | 0.82% |           |
| LLOYDS DEPOSIT | 4,000,000         | 364 DAYS       | 15/02/2012 | 13/02/2013    | 3.10% |           |
| BOS DEPOSIT    | 1,000,000         | 3 MONTHS       | 16/03/2012 | 18/06/2012    | 1.40% |           |
| BOS DEPOSIT    | 2,500,000         | 3 MONTHS       | 27/03/2012 | 27/06/2012    | 1.40% |           |
| <b>TOTAL</b>   | <b>18,922,000</b> |                |            |               | 1.39% | 0.50%     |

SUMMARY

|                         | BALANCE DEPOSITED | LIMIT AS PER STRATEGY | AVAILABLE CAPACITY TO INVEST |
|-------------------------|-------------------|-----------------------|------------------------------|
| BANK OF SCOTLAND/LLOYDS | 7,500,000         | *10,000,000           | 2,500,000                    |
| RBS MMIF                | 1,447,000         | 5,000,000             | 3,553,000                    |
| RBS                     | 4,484,000         | *10,000,000           | 5,516,000                    |
| BARCLAYS                | 991,000           | 5,000,000             | 4,009,000                    |
| IGNIS MMIF              | 4,500,000         | 5,000,000             | 500,000                      |
| BLACKROCK MMIF          | 0                 | 5,000,000             | 5,000,000                    |
|                         | <b>18,922,000</b> | <b>37,500,000</b>     | <b>18,578,000</b>            |

\*As per amendment to the Treasury Management Strategy 2011/12 on 13 October 2011 in relation to semi-nationalised banks