

REPORT TO GOVERNANCE AND AUDIT COMMITTEE

REPORT OF: HEAD OF FINANCE

REPORT NO: HOF 198

DATE: 29th June 2012

TITLE:	Annual Report on Treasury Management Activity 2011/12	
KEY DECISION OR POLICY FRAMEWORK PROPOSAL:	None	
PORTFOLIO HOLDER: NAME AND DESIGNATION:	Councillor Mike Taylor Well Run Council Portfolio Holder	
CONTACT OFFICER:	David Scott, Finance Support Manager 01476 406218 Email: d.scott@southkesteven.gov.uk	
INITIAL IMPACT ASSESSMENT:	Carried out and Referred to in paragraph (7) below:	Full impact assessment Required:
Equality and Diversity	N/A	No
FREEDOM OF INFORMATION ACT:	This report is publicly available via the Your Council and Democracy link on the Council's website: www.southkesteven.gov.uk	
BACKGROUND PAPERS	HOF148 – Budget 2011/12 3 rd March 2011. HOF174 – Treasury Management 2011/12 mid-year review 1 st December 2011 HOF 177 - 2011/12 Treasury Management Strategy Update 1 st December 2011 HOF 183 - 2011/12 Treasury Management Strategy Update 8 th December 2011	

1. RECOMMENDATION

Members are asked to note and approve the contents of the annual report on Treasury Management Activity for 2011/12.

2. PURPOSE OF THE REPORT

This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2011/12. 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 2011/12 the Council adhered to the suggested minimum reporting requirements as members received the following reports:

- an annual treasury strategy in advance of the year (Council 3rd March 2011)
- a mid-year (minimum) treasury update report (Governance and Audit Committee 1st December 2011)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

Governance and Audit Committee has delegated powers from Council to deal with matters relating to the Councils Treasury Management activities. Specifically it has the responsibility to monitor, review and amend as appropriate the Council approved Treasury Management Strategy during the course of the financial year. During the course of 2011/12 the committee has exercised in part its delegated powers by reviewing and recommending to Council an updated Treasury Management Strategy at its meeting on 1 December 2011 (HOF177).

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.

3. DETAILS OF REPORT

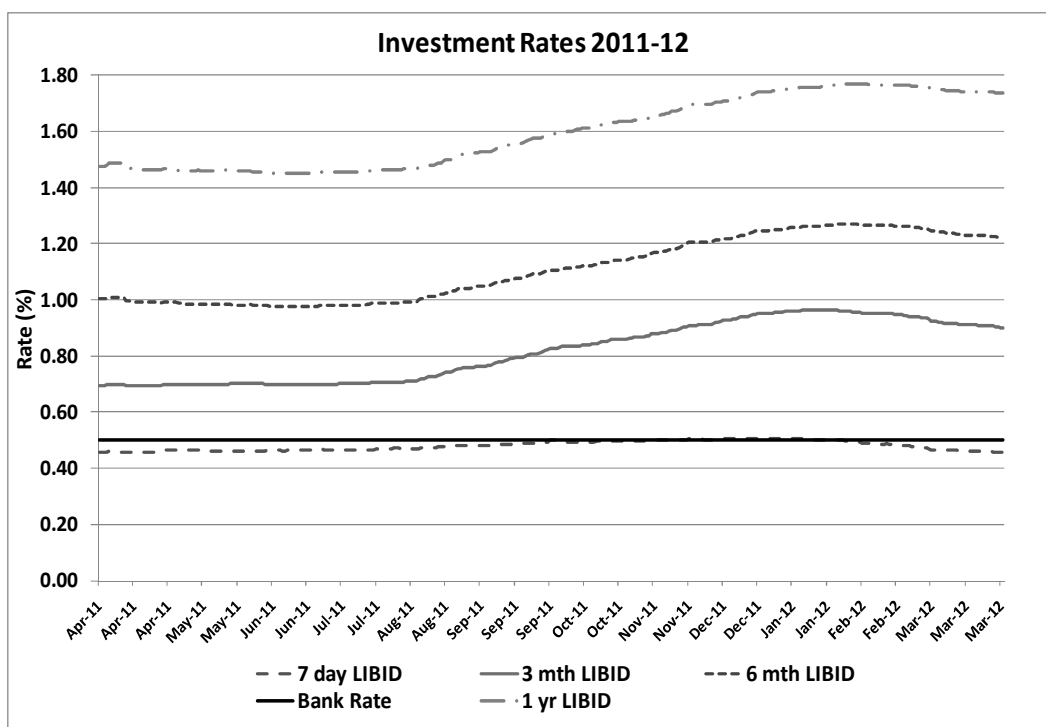
The Economy

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 and more recently a package for Spain has also been agreed. 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.

Interest Rates

During the course of 2011/12 the official Bank Rate remained at 0.5% for the whole of the financial year. Monetary policy was left on hold as the Bank of England looked to promote recovery in economic activity and facilitate the continued improvement to the

UK financial system. The table below highlights the impact of interest rates on investment returns



During the year the Council experienced short term fixed term investment rates ranging from 1.12% to 3.10%, and long term at 2.8%.

Treasury Position at 31 March 2012

A summary of the Councils position for 2011/12 was as follows:

Actual borrowing position	31 March 2011		31 March 2012	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	£2.500 m	9.975%	£124.152m	2.960%
Capital Financing Requirement	£6.986m		£128.707m	
Over/(Under) borrowing	(£4.486m)		(£4.555m)	
Investment position	31 March 2011		31 March 2012	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Investments	£30.000 m	2.48%	£26.400 m	1.33%
Variable Interest Investments	£1.410m	0.81%	£6.605 m	0.76%
Total Investments	£31.410m	1.94%	£33.005m	1.24%
Net borrowing position	(£28.910m)		£91.147m	

The Strategy Agreed for 2011/12

The strategy for 2011/12 was approved by Council on 3rd March 2011. However, in light of the HRA self-financing payment made on 28th March 2012 it was necessary to update the strategy to reflect the increase in borrowing. Under Part 1 of the Local Government Act 2003, the Council is required to have regard to the Prudential Code for Capital Finance including the setting of Prudential Indicators. Therefore, as the Council's borrowing position changed significantly in March 2012 the relevant treasury management indicators were updated to reflect this and allow the required borrowing to take place.

In addition to the above and in conjunction with the Council's Treasury Management advisors a review was undertaken during the year on the Treasury Management Practice relating to credit and Counterparty risk management. This led to one change being made to include the criterion of allowing investments to be placed with part-nationalised institutions, as these counterparties would fall within the specified investment category to reflect their high credit quality as they are part owned by the Government.

These changes were incorporated into an amended Treasury Management Strategy which was approved by Council on 8th December 2012.

Borrowing Requirement and Debt

The Council's underlying need to borrow to finance capital expenditure is termed the Capital Financing Requirement (CFR).

The implementation of housing finance reform at the end of the year abolished the housing subsidy system financed by Central Government and, consequently, all housing debt has been reallocated nationally between housing authorities. The result of this re-allocation is that this Council made a capital payment to the Department of Communities and Local Government of £121.652m. This resulted in an increase in the CFR of £128.707m at the end of the year which was financed by internal borrowing of £4.555m and external borrowing of £124.152m. There has been no impact on HRA revenue finances in 2011/12 due to compensating adjustments being made in the HRA determination.

	31 March 2011 Actual	31 March 2012 Revised	31 March 2012 Actual
CFR General Fund (£m)	£4.827m	£4.663m	£4.534m
CFR HRA (£m)	£2.159m	£124.480m	£124.173m
Total CFR	£6.986m	£129.143m	£128.707m

Actual debt management activity during 2011/12

Long Term Borrowing – £121.652m Additional long term borrowing was required in the period ended 31 March 2012 in relation to the HRA self financing payment and £2.5m PWLB (Public Work Loans Boards) loans are long term debt, outstanding at 31 March 2012.

Short-Term/Temporary Borrowing - No short term borrowing was outstanding in the period ended 31 March 2012.

Debt rescheduling - No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Investment Outturn for 2011/12

Investment Policy – The Council's investment policy is governed by Communities for Local Government (CLG) Guidance, which has been implemented in the annual investment strategy approved on 3rd March 2011 and subsequently revised on 8th December 2011. The investment activity during the year complied to the approved strategy.

As at 31 March 2012 the Council held both long term investments of £3 million and short term investments of £30.005 million. Council's policy is to hold not more than 25% of investments as long term.

Short Term Fixed Deposits –In the year short term fixed deposits were made on 6 separate occasions for amounts ranging from £2 million to £6 million. £21 million of deposits were being lent out as at 31 March 2012. There was also £9.005m being invested in instant access deposit accounts including Money Market Funds.

Long Term Fixed Deposits –In the year long term fixed deposits were made on 1 occasion for £3 million. £3 million of deposits were being lent out as at 31 March 2012.

The average rate of our portfolio is 1.24%, compared with a budget assumption of average investment balances of £28.405m at 1.5% investment return. Whilst overall the performance rates were lower due to the depressed markets the actual amount of investment income generated was £399k compared to the budget figure of £230k. This is due to the average investment balance being higher than anticipated due to a realignment in the spend profiles across capital schemes. Also, for the 4th quarter of 2011/12 the average investment rate had risen to 1.71%.

Performance Indicators set for 2011/12

This service has set the following performance indicators:

- Debt – Average rate movement year on year
 - 2010/11 of 9.975% compared with 2011/12 average rate of 2.960%
- Investments – Internal returns above the 7 day LIBID rate
 - The Council exceeded the target 7 day LIBID rate of 0.48% through achieving average returns on short term deposits of 1.43%.

Appendix 1 provides more details of the prudential and treasury indicators for 2011/12

As part of role performed by our treasury advisors we are also provided with benchmarking comparative information across all their clients which helps the council understand how its investment portfolio is performing in relation to others. For the quarter ending 31st March 2012 our average weight of return was 1.71% compared to 1.39% for other district councils. This reflects the positive work undertaken within the team to maximise our investment returns whilst balancing the exposure to risk.

Expected Future Activity

The treasury advisors view is for the first increase in bank rate to be in April 2014. With low growth predictions for the UK, and financial markets unconvinced that politicians have resolved the Eurozone sovereign debt crisis, we are likely to continue to experience high levels of volatility. The Monetary Policy Committee is currently split on whether there needs to be another increase in QE in 2012, after some reasonably encouraging economic statistics, indicating that the fall in Gross Domestic Product in Q4 2011 looks like being a one off, rather than the start of a new trend towards recession.

The outlook for the global economy remains clouded with uncertainty. The UK economy has struggled to generate a sustained recovery so this offers little hope for a strong recovery in 2012, and possibly even into 2013. Consumer and business confidence levels are generally low and it is not easy to see potential for a significant increase in the growth rate in the short term.

Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before early 2014 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

Locally an updated Treasury Management Strategy for 2012/13 was presented to Council on the 1st March 2012 taking into consideration the current and future economic climate, whilst maintain the balance between Risk and Returns.

Summary

Despite a very challenging year given the continued nature of the economic climate the Council's Treasury Management functions have operated effectively during 2011/12 and have successfully achieved the following;

- Repayment of principals have been secured in all deposits;
- Council's cash liquidity requirement has been met throughout the financial year;
- Investment income levels have been higher than predicted;
- Complied with all prudential indicators set for 2011/12;
- Robust management of the Council's debt position;
- Performance Indicators set for 2011/12 have been achieved.
- Benchmarking information shows we are achieving a higher average weight of return compared to the group average.

4. OTHER OPTIONS CONSIDERED

None

5. RESOURCE IMPLICATIONS

These are stated in the report.

6. RISK AND MITIGATION (INCLUDING HEALTH & SAFETY AND DATA QUALITY)

Risk has been considered as part of this report and no exceptional / high risks have been identified.

7. ISSUES ARISING FROM EQUALITY IMPACT ASSESSMENT

None – this report is retrospective.

8. CRIME AND DISORDER IMPLICATIONS

None

9. COMMENTS OF FINANCIAL SERVICES

These are included in the report.

10. COMMENTS OF LEGAL AND DEMOCRATIC SERVICES

This report provides details of the Councils performance in respect of Treasury Management against policy set out as part of the Budget and Policy Framework. Members should note the performance and scrutinise any elements to assist the role of the Governance and Audit Committee in its review of the Treasury Management Strategy.

11. COMMENTS OF OTHER RELEVANT SERVICE MANAGER

None

12. APPENDICES:

Appendix 1 – Prudential and Treasury Indicators 2011/12

APPENDIX 1 – PRUDENTIAL AND TREASURY INDICATORS 2011/12

During 2011/12, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2010/11 Actual £000	2011/12 Revised £000	2011/12 Actual £000
Capital expenditure			
• General Fund	£4.962m	£2.337M	£2.639m
• HRA	£3.086m	£5.410M	£4.717m
• Total	£8.048m	£7.747M	£7.356m
Capital Financing Requirement:			
• General Fund	£4.827m	£4.663m	£4.534m
• HRA	£2.159m	£2.159m	£2.159m
• HRA due to housing finance reform (<i>if applicable</i>)		£122.321m	£122.014m
• Total	£6.986m	£129.143m	£128.707m
Net borrowing	(£28.910m)	£95.148m	£91.147m
External debt	£2.500m	£122.484m	£124.152m
Investments			
• Longer than 1 year	£4.000m	n/a	£3.000m
• Under 1 year	£27.410m	n/a	£30.005m
• Total	£31.410m	n/a	£33.005m

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 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 2011/12 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.

	2011/12 pre housing finance reform	2011/12 post housing finance reform
Authorised limit	£18.0m	£148.0m
Maximum gross borrowing position	£15.5m	£145.5m
Operational boundary	£4.0m	£133.0m
Average gross borrowing position	£2.5m	n/a

Ratio of financing costs to net revenue stream	31 March.2011 actual	2011/12 original limits	31 March.2012 actual
General Fund	(0.23%)	(0.51%)	%
HRA (applies only to housing authorities)	(0.36%)	(0.60%)	%

Summary of

TABLE 1	31 March 2011 Principal	Rate/ Return	31 March 2012 Principal	Rate/ Return
Total debt	£2.500m	9.975%	£124.152m	2.960%
CFR	£6.986m		£128.707m	
Over/ (under) borrowing	(£4.486m)		(£4.555m)	
Total investments	£31.410m	1.94%	£33.005m	1.24%
Net debt	(£28.910m)		£91.147m	

The maturity structure of the debt portfolio was as follows:

	31 March.2011 actual	31 March.2012 actual
Under 12 months	£0.000m	£0.000m
12 months and within 24 months	£0.000m	£1.000m
24 months and within 5 years	£1.500m	£0.500m
5 years and within 10 years	£1.000m	£26.000m
10 years and above	£0.000m	£96.652m

The exposure to fixed and variable rates was as follows:

	31 March 2011 Actual	31 March 2012 Actual
Fixed rate (principal or interest)	£30.000m	£26.400m
Variable rate (principal or interest)	£1.410m	£6.605m