

Annual Treasury Management Report 2010/11

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Purpose

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).

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 18/05/2011)
- a mid year (minimum) treasury update report (Executive 01/11/2010)
- an annual report following the year describing the activity compared to the strategy (this report)

In addition, this Council has received quarterly treasury management update reports by the Executive and Accounts, Audit & Risk Committees.

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 Accounts, Audit & Risk Committee before they were reported to the full Council. Member training on treasury management issues was undertaken during the year on 02/06/2011 in order to support Members' scrutiny role.

Executive summary

During 2010/11, 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	2009/10 Actual £000s	2010/11 Actual £000s
Actual capital expenditure	17,676	5,816
Capital Financing Requirement	(17,676)	(5,816)
Net borrowing	0	0
External debt	0	0
Investments <ul style="list-style-type: none"> • Longer than 1 year • Under 1 year • Total 	17,000 50,664 67,664	5,500 61,045 66,545

Other prudential and treasury indicators are to be found in the main body of this report.

The financial year 2010/11 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

Introduction and background

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 the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed investment activity.

1. The Council's Capital Expenditure and 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:

£000s	2009/10 Actual	2010/11 Actual
Capital expenditure	17,676	5,816
Total capital expenditure	17,676	5,816
Resourced by:		
• Capital receipts	16,897	4,509
• Government Grants & Other Contributions	455	383
• Use of Reserves	60	607
• Direct Revenue Financing	264	317
Total resources used	17,676	5,816

2. The Council's overall borrowing need

The Council's is debt free and does not currently have a borrowing requirement.

3. Treasury Position as at 31 March 2011

The Council's investment position is organised by the treasury management team 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:

The maturity structure of the investment portfolio was as follows:

	2009/10 Actual £000	2010/11 Actual £000
Investments		
• Longer than 1 year	17,000	5,500
• Under 1 year	50,664	61,045
• Total	67,664	66,545

4. The Strategy for 2010/11

The expectation for interest rates within the strategy for 2010/11 anticipated low but rising Bank Rate (starting in quarter 4 of 2011) with similar gradual rises in medium and longer term fixed interest rates over 2010/11. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. 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.

The actual movement in interest rates broadly followed the expectations in the strategy, as detailed in the following section.

5. 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

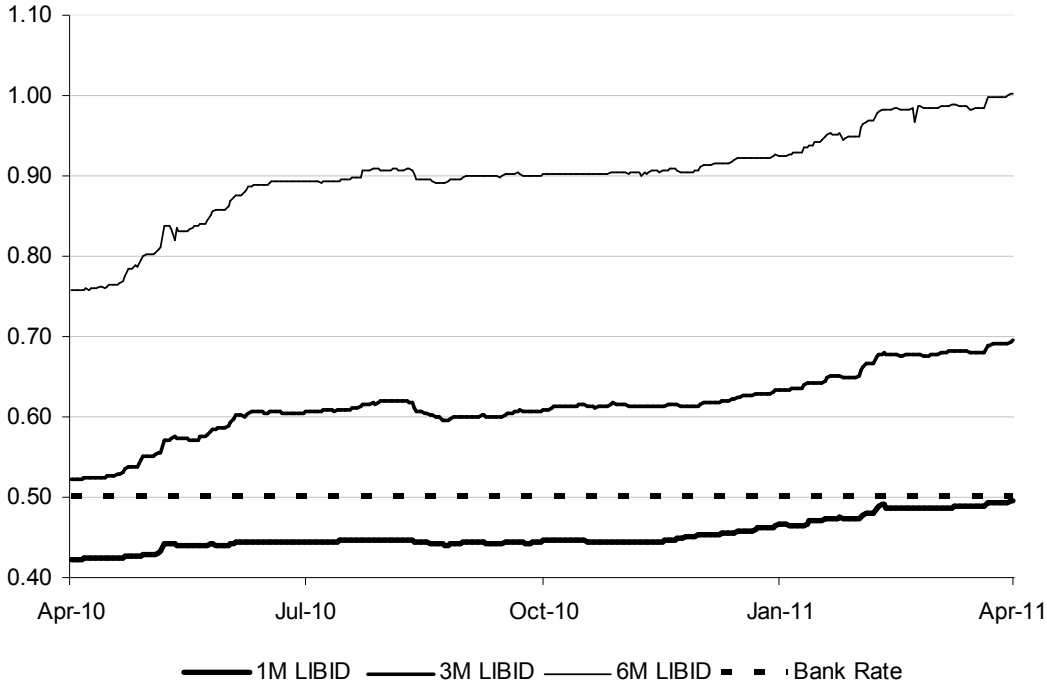
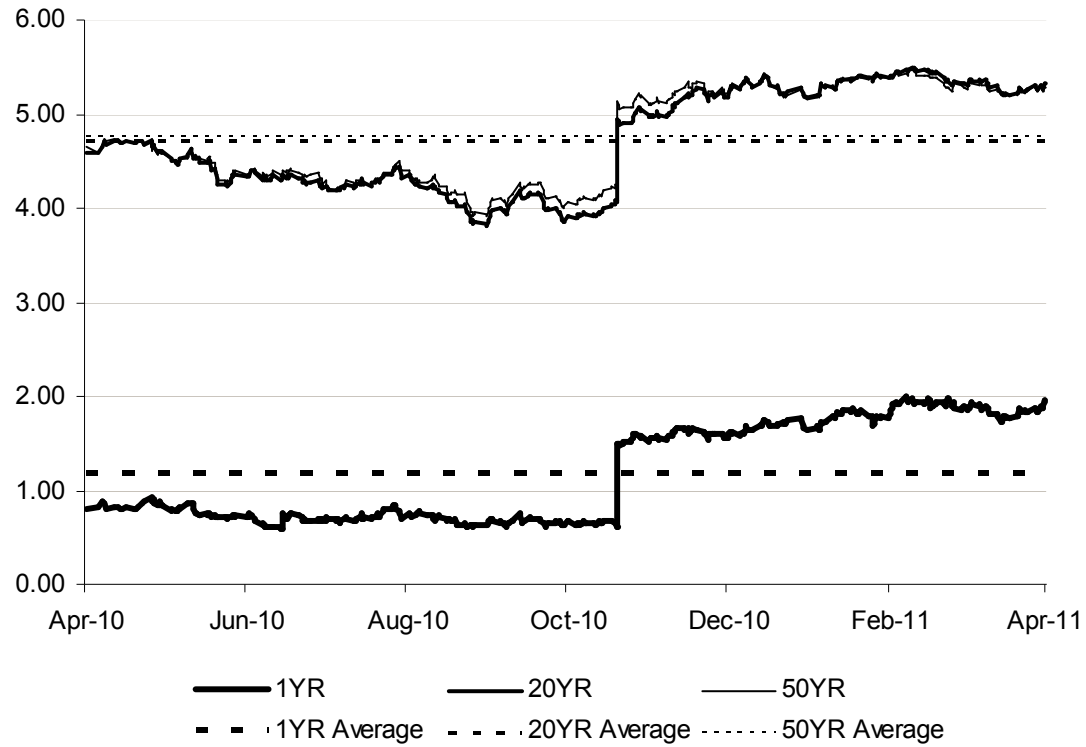


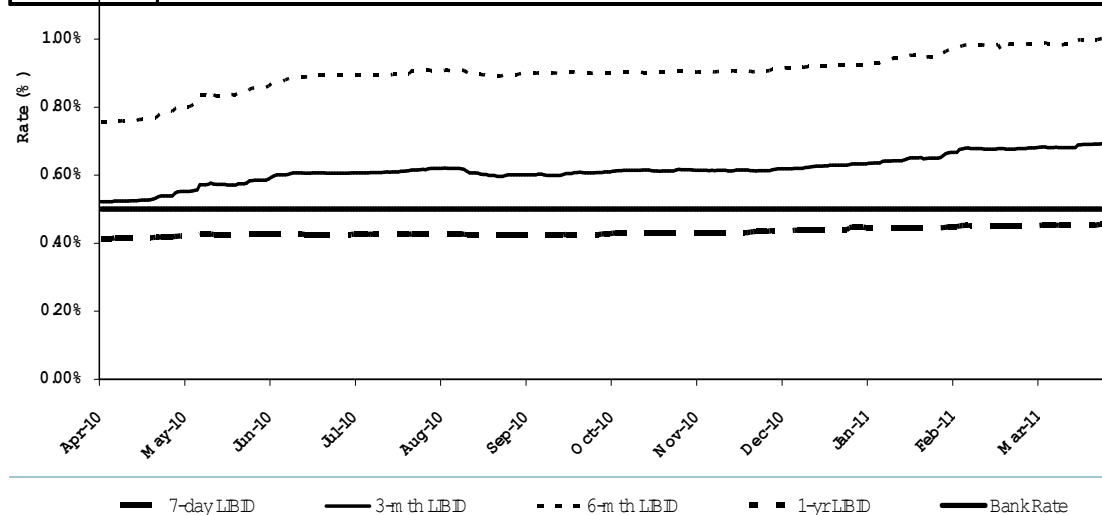
Chart 2: Average v new borrowing rates

6. 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



7. 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 Council on 18th May 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.).

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

Investments held by fund managers – the Council uses 2 external fund managers to invest part of its cash balances. The performance of the managers against the benchmark return was:

Fund Manager	Balance 01/04/10 £000s	Balance 31/03/11 £000s	Return £000s
In House	22,320	23,520	313
Tradition Uk	25,000	22,500	809
Investec	20,344	20,525	240
Total	67,664	66,545	1,362

This compares with a budget assumption of average investment balances of £60,344m 2.24% investment return. Performance during the year has been {insert summary on performance}.

8. Icelandic Bank Defaults

Cherwell District Council is one of at least 123 local authorities that have been affected by the collapse of Icelandic banking institutions. The Council has three deposits with the failed Icelandic bank Glitnir totalling £6.5 million. The bank was originally expected to confirm preferential creditor status to all UK local authorities meaning we would see the return of the full investment plus interest and costs during 2009/10.

However the bank's winding-up board is treating all local authority demands as general unsecured claims which would mean a return of only 29 per cent of the original investment only. All local authorities that have invested with Glitnir have been working with the Local Government Association and law firm Bevan Brittan to resolve this issue over the last 18 months.

On 1 April 2011 the Council was successful in the Icelandic Court in securing preferential creditor status but there remains the possibility of an appeal against this decision to the Icelandic Supreme Court so the final position cannot yet be stated with certainty.

The latest estimates provided by CIFPA in LAAP Bulletin 82 published in May 2011 indicate that total assets of the bank only equate to 29% of its liabilities. Therefore, if preferential creditor status is not achieved the recoverable amount may only be 29p in the £ indicating a potential liability of £4.6 million.

Although the Council remains confident of getting 100% of its investment back a plan was drawn up to deal with any loss via a capitalisation request and use of the Council's reserves. This strategy was been built into the MTFS.

On the advice of the Council's treasury advisors the Council has written off £4.6million in the 2010/11 accounts utilising the capitalisation direction and earmarked reserve. Should the current legal decision stand after the appeal process and 100% recovery is made then this will be treated as windfall income in 2011/12 accounts.

We will continue to work with the Local Government Association and Bevan Brittan to achieve the best possible return from our investment within the shortest possible timescales.

Appendix 1: Prudential and treasury indicators (subject to updates once Financial Statements approved)

The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. This total expenditure can be paid for immediately by resources such as capital receipts, capital grants etc. However, where these resources are insufficient any residual expenditure will form a borrowing need.

The summary capital expenditure projections are shown below and this forms the first prudential indicator:

	2 0 0 9 / 1 0 A c t u a l £ 0 0 0 s	2 0 1 0 / 1 1 E s t i m a t e d £ 0 0 0 s	2 0 1 1 / 1 2 E s t i m a t e d £ 0 0 0 s	2 0 1 2 / 1 3 E s t i m a t e d £ 0 0 0 s	2 0 1 3 / 1 4 E s t i m a t e d £ 0 0 0 s
Capital Expenditure 2011/1	17,67	5,582	13,92	5,704	5,999

2 approved	6		3		
Financed by:					
Capital receipts	(1 6 , 8 9 7)	(4 , 9 0 7)	(1 1 , 9 2 6)	(5 , 3 0 6)	(5 9 9)
Capital grants	(4 5 5)	(3 7 5)	(3 7 5)	-	-
Revenue funded reserves	(6 0)	(3 0 0)	(1 , 6 2 2)	(3 9 8)	-
Direct Revenue Financing	(2 6 4)	-	-	-	-
Net financing	-	-	-	-	-

need for the year					
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The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of Council's underlying borrowing need. The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision), although it is also allowed to undertake additional voluntary payments.

The Council is debt free and has no plans to enter into any long term debt arrangements. As such this section is largely irrelevant but is included for completeness if there was a decision to go back into debt. Therefore, the Council has a nil Minimum Revenue Provision for 2011/12.

The Council is asked to approve a NIL CFR projection as in the following table:

Capital Financing Requirement	2 0 0 9 / 1 0 A c t u a l £ 0 0 0 s	2 0 1 0 / 1 1 E s t i m a t e d £ 0 0 0 s	2 0 1 1 / 1 2 E s t i m a t e d £ 0 0 0 s	2 0 1 2 / 1 3 E s t i m a t e d £ 0 0 0 s	2 0 1 3 / 1 4 E s t i m a t e d £ 0 0 0 s
Capital Financing Requirement:					
Total CFR	-	-	-	-	-
Movement in CFR	-	-	-	-	-
Movemen t in CFR represent					

ed by:					
Net financing need for the year (above)	-	-	-	-	-
MRP/VRP and other financing movements	-	-	-	-	-
Movement in CFR	-	-	-	-	-

The Use of the Council's resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2009/10 Actual £000s	2010/11 Estimated £000s	2011/12 Estimated £000s
Fund balances	(1,777)	(1,200)	(1,200)
Capital receipts	(46,290)	(37,728)	(23,805)
Earmarked reserves	(7,070)	(6,820)	(6,820)

Total Core Funds	(55,137)	(45,748)	(31,825)
Working Capital*	(9,382)	(9,382)	(9,382)
Expected Investments	(64,519)	(55,130)	(41,207)

* Working capital balances are estimated year end; mid year may be higher

Limits to Borrowing Activity

Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits.

For the first of these the Council needs to ensure that its total borrowing net of any investments, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2010/11 and the following two financial years.

Borrowing	2009/10 Actual £000's	2010/11 Estimated £000's	2011/12 Estimated £000's
Gross Borrowing	-	-	-
Investments	(64,519)	(55,130)	(41,207)
Net Borrowing	(64,519)	(55,130)	(41,207)
CFR	-	-	-

The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

A further two prudential indicators control or anticipate the overall level of borrowing. These are:

- The Authorised Limit for External Debt – This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council.
- The Operational Boundary for External Debt – This indicator is based on the expected maximum external debt during the course of the year; it is not a limit.

The Council operates under the following Authorised Limit and Operational Boundary:

Authorised limit	2009/10 Actual £000s	2010/11 Estimated £000s	2011/12 Estimated £000s
Borrowing	10,000	10,000	10,000
Other long term liabilities	500	500	500
Total	10,500	10,500	10,500
Operational Boundary	2009/10 Actual £000s	2010/11 Estimated £000s	2011/12 Estimated £000s
Borrowing	-	-	-
Other long term liabilities	-	-	-
Total	-	-	-

Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. The Council is asked to approve the following indicators:

Actual and Estimates of the ratio of financing costs to net revenue stream – This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of interest against the net revenue stream. Since becoming debt free the indicator is negative because the Council has no borrowing but carries substantial investments.

	2009/10 Actual %	2010/11 Estimated %	2011/12 Estimated %
Non-HRA	-	-	-

Estimates of the incremental impact of capital investment decisions on the Council Tax – This indicator identifies the revenue costs associated with **new schemes** introduced to the three year capital programme recommended in the budget report compared to the Council's existing approved commitments and current plans.

Incremental impact of capital investment decisions on the Band D Council Tax

	2011/12	2012/13	2013/14
Council Tax - Band D	£0.36	(£0.25)	(£0.50)

Treasury Management Prudential Indicators and Limits on Activity

The Council then has three further treasury prudential indicators:

	2011/12	2012/13	2013/14
Interest rate Exposures			
	Upper	Upper	Upper
Limits on fixed interest rates	100%	100%	100%

based on net debt			
Limits on variable interest rates based on net debt	40%	40%	40%
Maturity Structure of fixed interest rate borrowing 2011/12			
	Lower	Upper	
Under 12 months	0%	100%	
12 months to 2 years	0%	0%	
2 years to 5 years	0%	0%	
5 years to 10 years	0%	0%	
10 years and above	0%	0%	
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£m	£m	£m
	0	0	0