Wiltshire Council

Council

9 November 2010

Annual Report on Treasury Management 2009-10

Summary

In accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities 2003 (The Prudential Code), the Council adopted a Treasury Management Strategy (TMS) for 2009-10, including a set of Prudential Indicators (PrIs) and an Annual Investment Strategy (AIS) at its meeting on 24 February 2009. This report shows how the Council has performed against this strategy.

The report was noted and approved at the meeting of Cabinet on 14 September 2010.

Proposal

Council is asked to consider and note:

a) the actual cash position at the end of 2009-10 against the original forecast for the year;
b) PrIs and other treasury management strategies set for 2009-10 against actual positions resulting from actions within the year as detailed in Appendix A; and
c) investments during the year in the context of the Annual Investment Strategy as detailed in Appendix B.

Reasons for Proposals

To give members of the Council an opportunity to consider the performance of the Council against the parameters set out in the last approved Treasury Management Strategy.

Council is required to consider this report by the Prudential Code for Capital Finance in Local Authorities and the CIPFA Code of Practice for Treasury Management in the Public Services.

Michael Hudson
Interim Chief Finance Officer

Wiltshire Council

Council

9 November 2010

Annual Report on Treasury Management 2009-10

Background & Purpose of Report

1. In accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities 2003 (The Prudential Code), the Council adopted a Treasury Management Strategy (TMS) for 2009-10, including a set of Prudential Indicators (PrIs) and an Annual Investment Strategy (AIS) at its meeting on 24 February 2009.

2. An interim report was submitted to Cabinet on 15 December 2009 for the period from 1 April to 30 September 2009. This report covers the whole financial year ended 31 March 2010

3. This report was previously submitted to Cabinet on 14 September 2010, where it was noted and approved.

Main Considerations for the Cabinet

4. This report reviews:

    a) the actual cash position at the end of 2009-10 against the original forecast for the year;

    b) PrIs and other treasury management strategies set for 2009-10 against actual positions resulting from actions within the year (see Appendix A); and

    c) investments during the year in the context of the Annual Investment Strategy (see Appendix B).

Review of cash position

5. In setting strategies and PrIs for 2009-10, a forecast cash position for the year was prepared based on expected inflows and outflows of cash during the year.

6. The actual cash position at 31 March 2010 is a cash requirement of £37.3 million, against an initial forecasted cash requirement of £25.6 million. This does not represent a loss to the council, it is how much extra cash was required to manage the councils overall liquid resources, which has no impact on the councils revenue budget, compared to how much was originally forecast. The cash forecast for 2009-10, the first year of unitary status, was difficult to quantify in terms of the information available from all five authorities at the time the forecast was set. The variance relates to both capital and revenue items, from both actual receipts and payments against forecasts, no single area being individually identifiable as the main variance. Once a pattern of spend and

income has been established for the new council a more accurate cash forecast will be possible. This will be available for 2010-11.

7. There were no opportunities to restructure PWLB loans in 2009-10 due to, both, interest rates at the appropriate maturity profiles and the high level of premiums payable for the early repayment of PWLB loans.

8. New PWLB loans totalling £20 million were taken up in February 2010, 'freeing up' surplus cash to invest in the short term and improving the 'spread' of the loan maturity profile.

Review of Prudential Indicators and Treasury Management Strategy for 2009-10

9. The detail of the review is given in Appendix A. The Cabinet is asked to note that:

   a) all action has been within the agreed PrIs;

   b) the average interest rate for long term debt is 4.30%, compared to 4.29% in 2008/09;

   c) short term cash deficits and surpluses were managed through temporary loans and deposits with a return on investments of 0.57% (4.58% in 2008-09, the reduction reflects the significant decrease in the level of interest rates since October 2008), in comparison to a market rate of 0.50%, based on the Average 3 Month LIBID Rate for 2009/10 (London Interbank Bid rate, i.e. the rate at which banks are prepared to borrow from other banks); and

   d) two Money Market Funds were opened, within which several investments (advances and withdrawals) were processed, during the year. No cost effective opportunity arose to obtain increased investment returns within acceptable risk levels from investment with External Cash Managers.

Review of Investment Strategy

10. This review is detailed in Appendix B. The Cabinet is asked to note that:

   a) there was an unavoidable deviation from the approved Annual Investment Strategy, the possibility of which was brought to the attention of the Implementation Executive at its meeting on 29 January 2009 and the County Council at its meeting on 24 February 2009. As stated in paragraphs 27 and 28 of the approved Treasury Management Strategy for 2009-10, "27. The district councils currently hold investments with maturity dates beyond 1st April 2009, leading to two potential risks of breaching the proposed Treasury Management Strategy when combining these with investments held by the County Council. (leading to a breach of the proposed Treasury Management Strategy): a) in terms of maximum investment limits for individual financial institutions and/or groups of financial institutions; and b) where the districts currently hold investments, the maturity dates of which are later than 31st March 2009, that, because of differing strategies, do not meet the proposed Treasury Management Strategy. 28. In the event that the potential risks in the previous paragraph are realised, it is proposed that the investments causing the realisation are allowed to continue until maturity. In addition it is proposed that IE agree that all Councils adopt the New Council Investment Strategy immediately to mitigate and limit this risk."

b) A £1 million, three year, investment held by one of the former district councils, North Wiltshire in this case, that matured after 1 April 2009, was carried as a Council investment until it matured on 27 April 2010. The counterparty (Kent Reliance Building Society) with which the investment was held did not meet the high credit ratings as required by the new Authority's Investment Strategy.

c) no long term investment opportunities were identified.

Environmental and Climate Change Considerations

11. a) to d) None have been identified as arising directly from this report.

Equalities Impact of the Proposal

12. None have been identified as arising directly from this report.

Risks Assessment and Financial Implications

13. The primary treasury management risks to which the Council is exposed are adverse movements in interest rates and the credit risk of counterparties.

14. Investment counterparty risk is controlled by assessing and monitoring the credit risk of borrowers as authorised by the Annual Investment Strategy. Appendix B of this report details action taken in 2009-10.

15. At 31 March 2010, the Council's average interest rate in respect of long term debt was 4.30%, which, according to the latest available information, remains one of the lowest rates amongst UK local authorities.

16. It is also considered important to ensure that there is an even spread of loans to avoid the prospect of a large number (and value) of loans maturing in any one year, which may need to be replaced when interest rates are high. A summary of the present maturity profile is shown in Appendix C (i).

17. Whilst returns on investments have decreased markedly, mainly as a result of the 'credit crunch', since October 2008 and are likely to continue at near current levels for a while, the costs of borrowing have remained at similar levels because the loan profile is almost entirely at fixed maturity rates. However, the average rate of borrowing is relatively low and the Council retains sufficient flexibility in its strategy with a reasonable balance between the costs of borrowing and return on investments. The investment rate of return for the year was 0.57%, against an average borrowing rate of 4.30%.

Legal Implications

18. None have been identified as arising directly from this report.

<u>Options Considered</u>

19. Additional call accounts, providing 'instant access' to cash surpluses, have been opened with highly credit rated counterparties, paying competitive rates of interest.

20. The opening of two Money Market Funds means that the Council can take advantage of an alternative form of 'instant access account', whilst obtaining a higher return than that gained from placing the cash on fixed short term, or overnight (with HSBC), deposit.

21. Longer term investments were considered, however, in the present economic climate it was decided to continue to keep investments short, pending further certainty in the financial markets, particularly following the failure of the Icelandic banks.

22. The Bank Rate is expected to rise in 2011 and reach 4.5% by March 2013. PWLB rates are also expected to rise steadily over the next three years as the UK economy improves. With this in mind, it was decided to borrow an additional £20 million new PWLB loans in February 2010, reducing the gap between CFR and net borrowing and thus lowering the level of internal borrowing, together with 'smoothing' the spread of the loan maturity profile and 'freeing up' surplus cash for short term investment.

<u>Conclusions</u>

23. Council is asked to note the report.

Michael Hudson
Interim Chief Finance Officer

Report Author:

Keith Stephens, Principal Accountant – Treasury and VAT, Tel: 01225 713603, email: <u>keith.stephens@wiltshire.gov.uk</u>

Background Papers

The following unpublished documents have been relied on in the preparation of this Report: NONE

Appendices

Appendix A - Review of Prudential Indicators for 2009-10
Appendix B - Investment Strategy for 2009-10
Appendix C(i) - Summary of long term borrowing 1 April 2009 - 31 March 2010
Appendix C(ii) – Summary of temporary loans and deposits 1 April 2009 – 31 March 2010

APPENDIX A

REVIEW OF PRUDENTIAL INDICATORS FOR 2009-10

1. Where appropriate the figures shown in this report are consistent with future years' estimated PrIs, which were reviewed and reported as part of the 2009-10 budget process.

PrI 1 - Capital Expenditure

2. The table below shows the original and revised estimate of capital expenditure against the actual for the year 2009-10:

	2009-10 Original Estimate £ million	2009-10 Revised Estimate £ million	2009-10 Actual Outturn £ million
Capital Expenditure	131.7	128.8	107.2

3. The Capital Programme has been actively managed throughout the year, including a number of reprofiling. The revised capital budget (capital outturn position for 2009-10) is £124.6 million. Details are as reported in the capital outturn report presented to the Cabinet at its meeting on 22 June 2010.

PrI 2 – Ratio of Financing Costs to Net Revenue Stream

4. PrI 2 expresses the net costs of financing as a percentage of the funding receivable from the Government and council tax payers. The net cost of financing includes interest and principal repayments for long and short term borrowing, as well as other credit-like arrangements, netted off by interest receivable in respect of cash investments.

	2009-10 Original Estimate	2009-10 Revised Estimate	2009-10 Actual
Financing Costs as a percentage of Revenue Budget	6.3%	5.8%	5.2%

5. The actual is below the revised estimate due to increased investment income.

PrI 3 – Estimate of Incremental Impact of Capital Investment Decisions on the Council Tax

6. This indicator is only relevant during budget setting, as it reflects the impact on the Band D Council Tax caused by any agreed changes in the capital programme.

PrI 4 – Net Borrowing and the Capital Financing Requirement

7. PrI 4 measures the so called "Golden Rule" which ensures that over the medium term net borrowing is only for capital purposes. The table below shows the original and revised estimate for 2009-10 compared with the actual position at the year end.

	2009-10 Original Estimate £ million	2009-10 Revised Estimate £ million	2009-10 Actual £ million
Capital Financing Requirement	275.0	259.9	299.5
Net Borrowing	137.2	113.6	142.6
Capital Financing Requirement not funded by net borrowing	**137.8**	**146.3**	**156.9**

8. The Capital Financing Requirement (CFR) increases whenever capital expenditure is incurred. If resourced immediately (from capital receipts, direct revenue contributions or capital grant/contributions) the CFR will reduce at the same time that the capital expenditure is incurred, with no net increase in CFR.

9. Where capital expenditure is not resourced immediately, there is a net increase in CFR, represented by an underlying need to borrow for capital purposes, whether or not external borrowing actually occurs. The CFR may then reduce over time by future applications of capital receipts, capital grants/contributions or further charges to revenue.

10. This PrI is necessary, because under an integrated treasury management strategy (in accordance with best practice under the CIPFA Code of Practice on Treasury Management in the Public Services), borrowing is not associated with particular items or types of expenditure, whether revenue or capital

11. Net Borrowing is the Council's total external debt less its short term cash investments.

PrI 5a – External debt

	31/3/09 Actual £ million	31/3/10 Expected £ million	31/3/10 Actual £ million
Borrowing	186.3	185.2	205.2
Other Long Term Liabilities	0.2	0.2	£0.2
TOTAL	**186.5**	**185.4**	**205.4**

12. This PrI shows the gross External Debt outstanding at year end. The actual borrowing figure is outstanding long term borrowing as shown in Appendix C (i). The difference between expected and actual borrowing reflects the decision to borrow £20 million for the reasons explained in the main body of the annual report (see paragraph 7 of the report).

13. Details of all long term loans taken during the year are given in Appendix C (i).

14. In February 2010, following a meeting with our treasury advisers, it was agreed that the Council should take advantage of lower PWLB loan rates in anticipation that rates are likely to rise over the next three years, thus mitigating the risk of having to borrow at a future date when PWLB rates are higher.

PrI 5b – Operational Boundary for External Debt

Operational Boundary	2009-10 £ million	2010-11 £ million	2011-12 £ million	2012-13 £ million
Borrowing	302.0	326.1	365.1	360.2
Other Long Term Liabilities	0.2	0.2	0.2	0.2
TOTAL	**302.2**	**326.3**	**365.3**	**360.4**

15. This PrI is for gross borrowing and was set at a limit that would allow the Council to take its entire financing requirement as loans, if this was most cost effective. The limit was set to anticipate expected expenditure and it has not been exceeded during the period covered by this report. The maximum gross borrowing during the year being £205.2 million at 31 March 2010.

PrI 5c – Authorised Limit for External Debt

Authorised Limit	2009-10 £ million	2010-11 £ million	2011-12 £ million	2012-13 £ million
Borrowing	347.4	375.0	419.9	414.2
Other Long Term Liabilities	0.2	0.2	0.2	0.2
TOTAL	**347.6**	**375.2**	**420.1**	**414.4**

16. This Authorised Limit was not exceeded at any time during the year, as maximum borrowing was below the lower Operational Boundary.

PrI 6a – Upper Limit on Fixed Interest Rate Exposures

The Council's upper limit for fixed interest rate exposure for the period 2009-10 to 2012-13 is 100% of net outstanding principal sums.

PrI 6b – Upper Limit on Variable Interest Rate Exposures

The Council's upper limit for variable interest rate exposure is 22% for 2009-10, 20% for 2010-11, 20% for 2011-12 and 25% for 2012-13 of net outstanding principal sums.

17. All loans and investments are at fixed rates of interest.

PrI 7 – Maturity Structure of Borrowing

Limits on the Maturity Structure of Borrowing	Upper Limit	Lower Limit	Actuals 31/3/10
Maturing Period:			
- under 12 months	15%	0%	0.0%
- 12 months and within 24 months	15%	0%	0.0%
- 2 years and within 5 years	45%	0%	1.0%
- 5 years and within 10 years	75%	0%	1.9%
- 10 years and above	90%	0%	97.1%

18. With effect from 31 March 2009, as reflected in the Statement of Accounts for 2008-09 (also maintained within the draft Statement of Accounts 2009-10), in accordance with the latest recommendations contained within the Statement of Recommended Accounting Practice (SORP) and current guidance, a change was implemented to the treatment of market (LOBO – Lender Option, Borrower Option) loans, where maturity dates are based on the contractual life of the loan rather than the first option (call) date.

19. This was highlighted in both the Annual Report on Treasury Management 2008-09, presented to Cabinet at its meeting on 15 July 2009 and the Treasury Management Strategy 2010-11, which was approved by Cabinet at its meeting on 11th February 2010 (ratified by Full Council at its meeting on 23 February 2010), including the approval of the necessary change to the upper limit for the period of "10 years and above" in the maturity structure of borrowing under, PrI 7, to 100%.

20. In addition to the main maturity indicators it is considered prudent that no more than 15% of long term loans should fall due for repayment within any one financial year. The actual maximum percentage falling due for repayment in any one year is currently 6.3% (£13 million) in both 2052-53 and 2053-54. The average interest rate on present long-term debt is 4.30%, which, according to the latest available information, continues to be one among the lowest local authority rates.

PrI 8 – Total Principal Sums invested for periods longer than 364 days

21. This PrI is covered by the Annual Investment Strategy, which is detailed in Appendix B.

PrI 9 – Compliance with CIPFA Code of Practice for Treasury Management in the Public Services

The Council is and will continue to be fully compliant with the CIPFA Code of Practice for Treasury Management in the Public Services.

22. This Code of Practice has been complied with during 2009-10.

Other Treasury Management issues

Short Term Cash Deficits and Surpluses

23. It was agreed that temporary loans and deposits would be used to cover short term cash surpluses and deficits that arise during the year. Such borrowing or investments would be made to specific dates at fixed rates, with reference to the cash flow requirements. Investments have also been placed in Money Market Funds during the year.

24. The temporary loans and deposits used are summarised in Appendix C (ii).

Icelandic Bank Deposits

25. During 2009-10 the Council received three interim dividends from the administrators of Heritable Bank totalling £3,155,805. No repayments have been received from Landsbanki.

26. According to the latest available information, the Council should expect to receive a total repayment from Heritable of between 79 and 85 pence in the pound. Based on guidance from the Local Government Association and Bevan Brittan solicitors, the final total repayment from Landsbanki is expected to be around 95 pence in the pound. However, this (in line with current opinion) assumes that local authorities obtain priority status in terms of their deposits with the bank. In agreeing claims from creditors, Landsbanki Winding-up Board granted priority status to local authorities, but this decision has been challenged by a group of creditors (mainly bond holders) who are classified as general creditors. Their objections are currently the subject of litigation through the Icelandic courts. If the courts were to accept the objections and decide that priority status does not apply to local authority deposits, the Council would be classified as a general creditor and receive a reduced total final repayment of around 38 pence in the pound, based on current advice.

27. The deposits outstanding with Icelandic banks are shown in Appendix C (ii) at impaired value, impairment being calculated using CIPFA guidance contained within LAAP Bulletin 82, Update 2, May 2010, less the dividends which have been received from Heritable administrators.

Longer Term Cash Balances

28. In the current economic climate it is considered appropriate to keep investments short term and only invest with highly credit rated financial institutions, using Sector's suggested creditworthiness approach. Therefore, when available for investment, longer term cash balances were placed on short term deposits.

29. Should the situation change in the next financial year consideration will be given to investing longer term where rates are attractive, whilst maintaining considerations regarding security and liquidity of investments.

APPENDIX B

INVESTMENT STRATEGY FOR 2009-10

1. All investments of surplus cash balances were placed to ensure:

   a) the security of capital, deposits only being placed with financial institutions which met the **high credit ratings** laid down in the approved Strategy;

   b) the liquidity of investments, all deposits being placed for fixed periods at fixed rates of interest; and

   c) all such investments were in sterling and in “Specified Investments”, as prescribed in the DCLG Guidance on Local Government Investments (the “Guidance”).

2. As summarised on Appendix C (ii), 326 deposit transactions were processed during the year, with a gross value of £1,183.984 million. Of deposits placed, 153 were placed direct with HSBC Bank Treasury on the Council’s overnight deposit account, 78 in call accounts, 16 through money market funds and 79 were placed with other counterparties.

3. Details of the deposits outstanding at the end of the year, totalling £62.601 million, are shown in Appendix C (ii). These deposits represent the Council’s reserves both long term, such as the PFI and Insurance funds, and short term such as creditors or payments in advance and include the deposits that remain outstanding from Icelandic banks at impaired value less repayments.

4. Two Money Market Funds were opened during the year. The balances outstanding at the end of the year are also shown in Appendix C (ii).

5. The Council contracts with a treasury adviser, regularly reviewing credit ratings of potential organisations and their respective country's ratings, together with other 'tools' used to assess the credit quality of institutions such as credit default swaps. The Council uses this information to assess institutions with which it may place deposits or from which it may borrow, including interest rate forecasts for both borrowing and investment, together with setting a 'benchmark' borrowing rate. The Council's investment policy is 'aimed' at the prudent investment of surplus cash balances to optimise returns whilst ensuring the security of capital and liquidity of investments. However, the Council, like any other organisation, can be exposed to financial risk, which is negated as far as possible by the foregoing measures.

Appendix C (i)

SUMMARY OF LONG TERM BORROWING 1 APRIL 2009 - 31 MARCH 2010

LOANS RAISED During the Period

Date raised	Lender	Amount (£m)	Type	Interest rate (%)	Maturity date	No. of years
February	PWLB	2.000	Maturity	2.750	Jun-14	4.25
February	PWLB	2.000	Maturity	3.140	Jun-15	5.25
February	PWLB	2.000	Maturity	3.470	Jun-16	6.25
February	PWLB	2.000	Maturity	4.330	Jun-21	11.25
February	PWLB	2.000	Maturity	4.450	Jun-23	13.25
February	PWLB	2.000	Maturity	4.490	Jun-24	14.25
February	PWLB	2.000	Maturity	4.540	Jun-26	16.25
February	PWLB	2.000	Maturity	4.560	Jun-28	18.25
February	PWLB	2.000	Maturity	4.570	Jun-41	31.25
February	PWLB	2.000	Maturity	4.570	Jun-42	32.25
	Total	20.000				

Average period to maturity (years) **15.25**

Average interest rate (%) **4.09**

Maturity Profile at 31 March 2010

Year	Amount (£m)	%age	Average rate (%)
1 to 5 years	2.080	1.0	2.815
6 to 15 years	10.015	4.9	3.977
16 to 25 years	37.623	18.3	4.458
26 to 50 years	139.500	68.0	4.362
Over 50 years	16.000	7.8	4.110
Totals	205.218	100.0	4.325

Average period to maturity (years) **35.84**

Appendix C (ii)

SUMMARY OF TEMPORARY LOANS AND DEPOSITS 1 April 2009 - 31 March 2010

Deposits Outstanding at 31 March 2010

Borrower	Amount £m	Terms	Interest rate(%)
Blackrock Money Market Fund	10.951	No fixed maturity date	0.52
JP Morgan Money Market Fund	6.120	No fixed maturity date	0.57
HSBC Bank	5.200	No fixed maturity date	0.20
Bank of Scotland	7.639	No fixed maturity date	0.75
Svenska Handelsbanken	7.952	No fixed maturity date	0.75
Santander UK (formerly Abbey)	1.163	No fixed maturity date	0.80
Alliance and Leicester	1.130	No fixed maturity date	0.80
Clydesdale	14.999	No fixed maturity date	0.80
Kent Reliance	1.000	Fixed to 27-Apr	0.66
Heritable Bank	1.385	Est Recoverable Amount	6.00
Heritable Bank	0.924	Est Recoverable Amount	6.00
Heritable Bank	1.385	Est Recoverable Amount	6.00
Heritable Bank	0.463	Est Recoverable Amount	5.42
Landsbanki	2.290	Est Recoverable Amount	6.10
Total	62.601		

Outstanding deposits with Icelandic Banks are shown at the estimated recoverable amount, which takes account of estimated impairments and, in the case of Heritable, any repayments received to date. The interest rates are the original rates.

Transactions During the Period

Type	Balance 1 Apr 09 £m	Raised		Repaid		Balance 31 Mar 10 £m	Interest variance * high/low(%)
		Value £m	No.	Value £m	No.		
Temporary loans							
- General	0.000	0.000	0	0.000	0	0.000	
Total	0.000	0.000	0	0.000	0	0.000	
Temporary deposits							
- General	46.994	434.101	79	473.648	87	7.447	1.58/0.20
- Call Accounts	12.501	161.262	78	140.880	54	32.883	1.20/0.80
- Money Market Funds	0.000	34.771	16	17.700	4	17.071	0.75/0.34
- HSBC Treasury	0.850	553.850	153	549.500	154	5.200	0.30/0.15
Total	60.345	1,183.984	326	1,181.728	299	62.601	

* *Interest variance is the highest/lowest interest rate for transactions during the period*

General deposits include impaired Icelandic investments less any repayments received during the financial year