Wiltshire Council

Cabinet
26 July 2011

Subject:	**Annual Report on Treasury Management 2010-11**
Cabinet Member:	**Councillor John Brady - Finance, Performance and Risk**
Key Decision:	**No**

<u>Executive Summary</u>

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 and Treasury Indicators (PrIs/TrIs) and an Annual Investment Strategy (AIS) at its meeting on 23 February 2010. This report shows how the Council has performed against this strategy.

<u>Proposals</u>

The Cabinet is asked to consider and note:

a) the actual cash position at the end of 2010-11 against the original forecast for the year;
b) PrIs, TrIs and other treasury management strategies set for 2010-11 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.

<u>Reasons for Proposals</u>

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

This report is required 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

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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 2010-11, including a set of Prudential and Treasury Indicators (PrIs/TrIs) and an Annual Investment Strategy (AIS) at its meeting on 23 February 2010.

2. An interim report was submitted to Cabinet on 25 January 2011 for the period from 1 April to 30 September 2010. This report covers the whole financial year ended 31 March 2011.

Main Considerations for the Cabinet

3. This report reviews:

   a) the actual cash position at the end of 2010-11 against the original forecast for the year;

   b) PrIs, TrIs and other treasury management strategies set for 2010-11 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

4. In setting strategies and PrIs for 2010-11, a forecast cash position for the year was prepared based on expected inflows and outflows of cash during the year.

5. Expected cash flows are indicative and any surpluses or deficits in the cash position are managed through short term investments and borrowing and do not represent an actual gain or loss to the Council and do not have an impact on the revenue budget. Instead, any surplus or deficit represents, either: surplus cash (at a point in time), held pending allocation to related expenditure, which is invested on a short term basis until required; or additional cash required (at a point in time) to manage the Councils overall liquid resources. Any cash required being funded by a (contra) reduction in short term investments or increase in short term borrowing.

6. The actual cash position at 31 March 2011 is a cash requirement of £16.6 million, compared with the expected cash requirement of £43.7 million. The (favourable) variation of £27.1 million relates to both capital and revenue items, receipts and payments and is represented by an:

    a) increase in the actual level of investments of £19.2 million, compared to the anticipated decrease of £43.7 million (i.e. a variance of £62.9 million);

    b) increase in the level of borrowing of £40.0 million; and

    c) a decrease in the level of cash at bank of £4.2 million, giving

    d) a total variation of £(69.2 - 40.0 + 4.2) million = £27.1 million.

7. There were no opportunities to restructure PWLB loans in 2010-11, mainly because of the continuing high level of premiums payable for the early repayment of PWLB loans, together with the availability of favourable interest rates at the appropriate maturity levels.

8. PWLB rates are expected to rise steadily over the next three years as the UK economy improves. With this in mind, but also to maintain a positive cash position at the year end, it was decided to borrow an additional £40 million new PWLB loans in March 2011, 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.

Review of Prudential and Treasury Indicators and Treasury Management Strategy for 2010-11

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 approved PrIs and TrIs;

    b) the average interest rate for long term debt is 4.20%, compared to 4.30% in 2009-10;

    c) short term cash deficits and surpluses were managed through temporary loans and deposits with a return on investments of 0.66% (an increase from 0.57% in 2009-10, reflecting longer term investment opportunities at favourable rates of interest – see below), in comparison to a market rate of 0.61%, based on the Average 3 Month LIBID Rate for 2010-11 (London Interbank Bid Rate, i.e. the rate at which banks are prepared to borrow from other banks);

    d) two mid/longer term investments (one for six months and another for 12 months) were placed during the year with Barclays Bank and Lloyds Banking Group, respectively, taking advantage of 'special' direct deposits at favourable interest rates (whilst maintaining security and liquidity); and

    e) a further Money Market Fund was opened during the year.

Review of Investment Strategy

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

    a) the tight monetary conditions following the 2008 financial crisis continued through 2010-11 with little material movement in the shorter term deposit rates.

    b) Overlaying the relatively poor investment returns was the continued counterparty concerns, most evident in the Euro zone sovereign debt crisis.

    c) during the financial year the Council was able to take the opportunity presented by the 'pick up' in the six and 12 month investment rates to invest surplus cash balances at optimum rates, whilst maintaining its approved strategy, including security and liquidity and credit rating criteria.

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 2010-11.

15. At 31 March 2011, the Council's average interest rate in respect of long term debt was 4.20% (a reduction of 0.10% since 31 March 2010), 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 loan maturity profile is shown in Appendix C (i).

17. Returns on short term investments have not moved significantly, mainly as a result of the continuation of the conditions following 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 (despite the unexpected change of policy on PWLB lending arrangements in October 2010, when new borrowing rates increased by 0.75% to 0.85%, without an associated increase in early redemption 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 0.66%, against the average borrowing rate of 4.20%.

Legal Implications

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

Options Considered

19. The opening of another Money Market Fund means that the Council can take further advantage of an alternative (highly liquid) 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. Money market funds also spread the credit risk among the "members" of the fund.

20. Mid/longer term investment rates picked up a little during the financial year, leading to an opportunity to invest at special (attractive) deposit rates over six and 12 months. Other cash surpluses that arose were mainly placed in call accounts and money market funds offering competitive rates when compared with market rates, with the advantage of being highly liquid, whilst being within the Councils approved credit worthiness criteria. Where other investments were placed on the money market, in the present economic climate it was decided to continue to keep investments short, pending further certainty in the financial markets.

21. The latest forecast anticipates that Bank Rate will start to rise in quarter four of 2011 and reach 3% by March 2014. However, the forecast that the first increase in the Bank Rate will take place in November 2011 is anticipated with reservations and it could well slip back in time, unless there is some good news on the UK economy before then. PWLB rates are also expected to rise steadily over the next three years as the UK economy improves. With this in mind, but also to maintain a positive cash position at the year end, it was decided to borrow an additional £40 million new PWLB loans in March 2011, 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.

Conclusion

22. Cabinet is asked to note the report.

Michael Hudson
Interim Chief Finance Officer

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Background Papers

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

Appendices

Appendix A Review of Prudential and Treasury Indicators for 2010-11
Appendix B Investment Strategy for 2010-11
Appendix C Summary of Long Term Loans, Temporary Loans and Deposits

APPENDIX A

REVIEW OF PRUDENTIAL AND TREASURY INDICATORS FOR 2010-11

1. Where appropriate the figures shown in this report are consistent with future years' estimated PrIs/TrIs, which were reviewed and reported as part of the 2010-11 budget process.

Prudential Indicators

PrI 1 - Capital Expenditure

2. The table below shows the original and revised estimate of capital expenditure against the actual for the year 2010-11:

	2010-11 Original Estimate £ million	2010-11 Revised Estimate £ million	2010-11 Actual Outturn £ million
Capital Expenditure	137.0	124.3	114.6

3. The Capital Programme has been actively managed throughout the year and the revised capital budget (capital outturn position for 2010-11) is £121.3 million. Details are as reported in the capital outturn report presented to the Cabinet Capital Assets Committee at its meeting on 14 June 2011.

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.

	2010-11 Original Estimate	2010-11 Revised Estimate	2010-11 Actual
Financing Costs as a percentage of Revenue Budget	5.6%	5.5%	5.8%

5. The actual is in excess of the revised estimate due to increased borrowing costs.

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 2010-11 compared with the actual position at the year end.

	2010-11 Original Estimate £ million	2010-11 Revised Estimate £ million	2010-11 Actual £ million
Capital Financing Requirement	299.0	320.5	320.4
Net Borrowing	157.3	175.2	163.1
Capital Financing Requirement not funded by net borrowing	**141.7**	**145.3**	**157.3**

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 5 – Compliance with CIPFA Code of Practice for Treasury Management in the Public Services ("The Code")

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

12. This Code of Practice has been complied with during 2010-11.

Treasury Management Indicators within the Prudential Code

TrI 1 – Authorised Limit for External Debt

Authorised Limit	2010-11 £ million	2011-12 £ million	2012-13 £ million	2013-14 £ million
Borrowing	375.0	453.0	499.7	504.6
Other Long Term Liabilities	0.2	0.2	0.2	0.2
TOTAL	**375.2**	**453.2**	**499.9**	**504.8**

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

Tr 2 – Operational Boundary for External Debt

Operational Boundary	2010-11 £ million	2011-12 £ million	2012-13 £ million	2013-14 £ million
Borrowing	326.1	393.8	434.5	438.8
Other Long Term Liabilities	0.2	0.2	0.2	0.2
TOTAL	**326.3**	**394.0**	**434.7**	**439.0**

14. This TrI 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 £245.2 million at 31 March 2011.

TrI 3 – External debt

	31/3/10 Actual £ million	31/3/11 Expected £ million	31/3/11 Actual £ million
Borrowing	205.2	205.2	245.2
Other Long Term Liabilities	£0.2	0.2	£0.2
TOTAL	**205.4**	**205.4**	**245.4**

15. This TrI 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 £40 million for the reasons explained in the main body of the annual report (see paragraph 8 of the report).

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

Treasury Management Indicators within the Treasury Management Code

TrI 4a and 4b – Upper Limit on Fixed Interest Rate Exposures and Interest Rate Exposures, respectively

The Council's upper limit for fixed interest rate exposure for the period 2010-11 to 2013-14 is 100% of net outstanding principal sums.

The Council's upper limit for variable interest rate exposure is 16% for 2010-11, 20% for 2011-12, 30% for 2012-13 and 35% for 2013-14 of net outstanding principal sums.

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

TrI 5 – Maturity Structure of Borrowing

Limits on the Maturity Structure of Borrowing	Upper Limit	Lower Limit	Actuals 31/3/11
Maturing Period:			
- under 12 months	15%	0%	0.5%
- 12 months and within 24 months	15%	0%	0.0%
- 2 years and within 5 years	45%	0%	9.7%
- 5 years and within 10 years	75%	0%	8.8%
- 10 years and above	90%	0%	81.0%

18. 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 5.3% (£13 million) in both 2052-53 and 2053-54. The average interest rate on present long-term debt is 4.20%, which, according to the latest available information, continues to be one among the lowest local authority rates.

TrI 6 – Total Principal Sums invested for periods longer than 364 days

19. This TrI is covered by the Annual Investment Strategy, which is detailed in Appendix B.

Other Treasury Management issues

Short Term Cash Deficits and Surpluses

20. 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 cash flow requirements. Investments have also been placed in Money Market Funds during the year.

21. Temporary loans and deposits are summarised in Appendix C (ii).

Icelandic Bank Deposits

22. During 2010-11 the Council received three interim dividends from the administrators of Heritable Bank totalling £1,364,936. No repayments have been received from Landsbanki.

23. 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. Indeed, in terms of Heritable and Landsbanki, the position has not changed materially from the previous financial year end and the guidance regarding the level of expected returns remains the same. 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 the decision of the Reykjavik District Court on 1 April 2011 and current opinion that this decision will be upheld on appeal to

the Icelandic Supreme Court later in the year) assumes that local authorities retain priority status in terms of their deposits with the bank. In the unlikely event that the Supreme Court were to decide in favour of the appellants, 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.

24. 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 4, May 2011, less the dividends which have been received from Heritable administrators.

Longer Term Cash Balances

25. 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.

26. 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.

27. 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 mainly placed on short term deposits. However, the opportunity arose to take advantage of the pick up, in longer term rates and investments were made with two suitable counterparties during the financial year.

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

APPENDIX B

INVESTMENT STRATEGY FOR 2011-12

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

3. As summarised in Appendix C (ii), 326 deposit transactions were processed during the year, with a gross value of £1,073.826 million. Of deposits placed, 150 were placed direct with HSBC Bank Treasury on the Council’s overnight deposit account, 74 in call accounts, 76 through money market funds and 26 were placed with other counterparties.

4. Details of the deposits outstanding at the end of the year, totalling £82.067 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.

5. The opportunity was taken to place a proportion of these deposits in mid/longer term investments for six and 12 months, taking advantage of the pick up in interest rates for these maturity periods. These are shown within general deposits in Appendix C (ii).

6. A further Money Market Fund was opened during the year. The balances remaining within the (three) funds at the end of the year are also shown in Appendix C (ii).

7. 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 2010 - 31 MARCH 2011

LOANS RAISED During the Period

Date raised	Lender	Amount (£m)	Type	Interest rate (%)	Maturity date	No. of years
March	PWLB	10.000	Maturity	3.050	Mar-15	4.00
March	PWLB	10.000	Maturity	3.420	Mar-16	5.00
March	PWLB	10.000	Maturity	3.740	Mar-17	6.00
March	PWLB	10.000	Maturity	4.020	Mar-18	7.00
	Total	40.000				

Average period to maturity (years) **5.50**

Average interest rate (%) **3.56**

Maturity Profile at 31 March 2011

Year	Amount (£m)	%age	Average rate (%)
1 to 5 years	24.080	9.8	3.190
6 to 15 years	28.123	11.5	3.971
16 to 25 years	48.500	19.8	4.420
26 to 50 years	128.500	52.4	4.367
Over 50 years	16.000	6.5	4.110
Totals	245.203	100.0	4.200

Average period to maturity (years) **30.01**

SUMMARY OF TEMPORARY LOANS AND DEPOSITS 1 April 2010 - 31 March 2011

Deposits Outstanding at 31 March 2011

Borrower	Amount £m	Terms		Interest rate(%)
HSBC Bank PLC - Treasury	0.400	No fixed maturity date		0.25
Lloyds TSB Bank	5.000	Fixed to	11-Aug	2.05
Barclays Bank	15.000	Fixed to	15-Jun	1.10
Bank Of Scotland	2.910	No fixed maturity date		0.75
Santander UK	0.014	No fixed maturity date		0.80
Clydesdale Bank	14.314	No fixed maturity date		0.80
Svenska Handelsbanken AB	0.021	No fixed maturity date		0.75
Black Rock Money Market Fund	14.535	No fixed maturity date		0.58
JP Morgan Money Market Funds	10.037	No fixed maturity date		0.53
Prime Rate Money Market Fund	14.420	No fixed maturity date		0.77
Heritable Bank	1.002	Est Recoverable Amount		6.00
Heritable Bank	0.667	Est Recoverable Amount		6.00
Heritable Bank	1.002	Est Recoverable Amount		6.00
Heritable Bank	0.336	Est Recoverable Amount		5.42
Landsbanki	2.409	Est Recoverable Amount		6.10
Total	82.067			

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 at acquisition date.

Transactions During the Period

Type	Balance 1 Apr 10 £m	Raised Value £m	Raised No.	Repaid Value £m	Repaid No.	Balance 31 Mar 11 £m	Interest Variance * High/Low(%)
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	7.447	143.531	26	125.562	25	25.416	2.05/0.30
- HSBC Overnight	5.200	472.045	150	476.845	151	0.400	0.25/0.20
- Call Accounts	32.883	135.659	74	151.283	41	17.259	0.80/0.75
- Money Market Funds	17.071	322.591	76	300.670	68	38.992	0.85/0.36
Total	**62.601**	**1,073.826**	**326**	**1,054.360**	**285**	**82.067**	

* Interest variance is the highest/lowest interest rate for transactions during the period.
* In terms of general deposits, the high of 2.05% was obtained on a special 12 month deposit.

General deposits include impaired Icelandic investments less any repayments that have been received, to date.