Audit Committee – 23rd June 2011

12. 2010/11 Treasury Management Activity Report

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Purpose of the Report

1. To review the treasury management activity and the performance against the Prudential Indicators for the 2010/11 financial year as prescribed by the revised CIPFA Code of Practice and in accordance with the Council's Treasury Strategy and Annual Investment Policy and Treasury Management Practices.

Recommendations

2. The Audit Committee are asked to:

- Note the Treasury Management Activity for the 2010/11 financial year;
- Note the position of the individual prudential indicators for the 2010/11 financial year;
- Note the outlook for the investment performance in 2011/12
- Recommend the 2010/11 Treasury Management Activity Report to full Council

Background

3. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. The Council reports six monthly to Full Council against the strategy approved for the year. The scrutiny of treasury management policy, strategy and activity is delegated to the Audit Committee.

4. Treasury management in this context is defined as:

   "The management of the local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

5. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

Summary of Investment Strategy for 2010/11

6. The Council's strategy for investments is based upon minimising risk and safeguarding the capital sum. There is a reliance on the investment income receivable in maintaining a balanced revenue budget and therefore the long-term

strategy is to maintain stability by having a significant amount invested in fixed rate of return investment instruments.

7. Our minimum rating is A+ long term (or equivalent). Following the guidance from our advisors, Arlingclose we are keeping investments to a rolling programme of 12 months where cash flow permits.

8. The sum invested in longer dated securities at fixed rates of interest at the end of March 2011 represented 32.87% of the total portfolio. The sum invested in longer dated securities at variable rates of interest at the end of March 2011 represented 15.49% of the total portfolio. Investments made in longer dated securities comprise EuroSterling bonds and a Corporate bond; these investments have all been made following advice from our treasury advisers.

9. The Treasury Management Strategy Statement and Annual Investment Policy were both approved by Council on 18th March 2010. The strategy identified that the overall investment portfolio should, subject to current economic conditions, include investments in the following ranges:-

	%
Fund Managers and pooled managed funds.	0% - 25%
Term deposits (up to 2 years).	0% - 75%
3 – 5 year cash deposits.	0% - 25%
1 – 5 year callable deposits.	0% - 15%
1 – 5 year EuroSterling/Corporate Bonds.	10% - 75%

10. The table below compares the investment portfolio at 31st March 2011 to the investment strategy:-

	£'m	%	Strategic aim
Pooled Managed Funds and business reserve accounts	4.00	10.3	0% - 25%
Term deposits (up to 2 year)	16.00	41.3	0% - 75%
3 – 5 year cash deposits.	0	0	0% - 25%
1 – 5 year callable deposits.	0	0	0% - 15%
1 – 5 year EuroSterling/Corporate Bonds.	18.73	48.4	10% - 75%
	38.73	**100.0**	

The above table shows that the current investment portfolio broadly reflects the strategy.

Interest Rates 2010/11

11. Base rate began the financial year at 0.5% and has maintained this throughout 2010/11

12. Our advisors are forecasting that rates will continue at 0.5% during the remainder of this financial year with a likelihood of increasing by 0.25% in August 2011.

	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14
Official Bank Rate												
Upside risk	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.75	1.00	1.25	1.50	2.00	2.50	2.75	2.75	3.00	3.00	3.00
Downside risk	0.00	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

Investment Portfolio

13. The table below shows the Council's portfolio of investments at the start and end of the 2010/11 financial year;

	Value of Investments at 01.04.10 £	Value of Investments at 31.03.11 £	Fixed/ Variable Rate
Investments advised by Arlingclose			
Euro Sterling Bonds	9,850,072	7,537,881	Fixed
Corporate Bonds	5,336,559	5,194,979	Fixed
Euro Sterling Bonds	2,000,630	6,000,000	Variable
Total	**17,187,261**	**18,732,860**	
Internal Investments			
Short Term Deposits	19,000,000	16,000,000	Variable
Money Market Funds & Business Reserve Accounts	2,960,000	4,000,000	Variable
Total	**21,960,000**	**20,000,000**	
TOTAL INVESTMENTS	**39,147,261**	**38,732,860**	

Returns for 2010/11

14. The returns to 31st March 2011 are shown in the table below:

	Actual Income £'000	% Rate of Return
Investments advised by Arlingclose		
Euro Sterling Bonds (Fixed)	484	
Corporate Bonds	234	
Euro Sterling Bonds (Variable)	46	
Total	**764**	**3.76%**
Internal Investments		
Short Term Deposits	314	
Money Market Funds & Business Reserve Accounts	48	
Total	**362**	**1.27%**
Other Interest		
Miscellaneous Loans	150	
Total	**150**	
TOTAL	**1,276**	**2.23%**
PROFILED BUDGETED INCOME	**1,348**	
SHORTFALL	**72**	
BENCHMARK RATE OF RETURN		**0.43%**

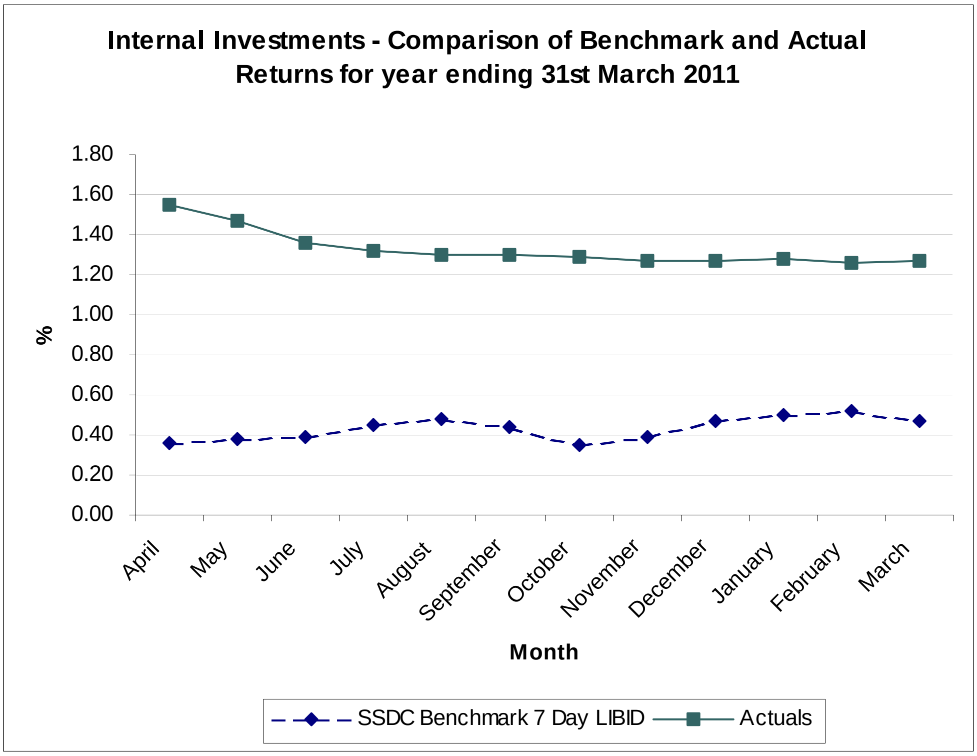
15. The table above shows investment income for the year compared to the profiled budget. The figures show a shortfall under budget of £72,000.

16. The outturn position is affected by both the amount of cash we have available to invest and the interest base rate set by the Bank of England. Balances are affected by the timing of capital expenditure and council tax and business rate collection.

17. The original Treasury Management budget of £1,347,620 was derived by forecasting an average rate of return of 2.74%. The actual interest rate received for the year was 2.23%.

Internal Investments (Short Term)

18. The graph below shows the In-house performance in respect of short-term investments as at 31st March 2011.



19. The current benchmark set for the in house team is the 7-day LIBID (London Interbank Bid) rate which is the rate used for quick benchmarking by the CIPFA benchmarking club.

20. The above graph shows that the internal investments returns are consistently outperforming the benchmark by around 80 basis points. This is due to maintaining a rolling programme of 12 month term deposits where cash flow permits. There is a large amount of our investment portfolio in longer dated securities such as Eurobonds and Corporate Bonds which have been secured at attractive rates (in comparison to what is currently achievable on these financial instruments) increasing our overall return even further.

Borrowing

21. An actual overall borrowing requirement (CFR) of £9.5 million was identified at the beginning of 2010/11. As interest rates on borrowing exceed those on investments the Council has used its capital receipts to fund capital expenditure. As at 31st March 2011, the Council had no external borrowing.

Breakdown of investments as at 31st March 2011

Date Lent	Counterparty	Amount	Rate	Maturity Date
10-Jan-11	Bank of Scotland	2,000,000	1.95%	10-Jan-12
14-Oct-10	Bank of Scotland	2,000,000	1.85%	14-Oct-11
1-Mar-11	Bank of Scotland	1,000,000	2.05%	1-Mar-12
15-Apr-10	Nationwide Building Society	1,000,000	1.25%	14-Apr-11
7-Jun-10	Nationwide Building Society	1,000,000	1.36%	7-Jun-11
6-Aug-10	Nationwide Building Society	1,000,000	1.36%	5-Aug-11
25-Aug-10	Barclays Bank Plc	1,000,000	1.47%	25-Aug-11
1-Sep-10	Barclays Bank Plc	1,000,000	1.47%	1-Sep-11
14-Jan-11	Nationwide Building Society	1,000,000	0.76%	27-May-11
4-Nov-10	Barclays Bank Plc	1,000,000	1.45%	4-Nov-11
17-Nov-10	Barclays Bank Plc	1,000,000	1.47%	17-Nov-11
23-Mar-11	Bank of Scotland	1,000,000	2.05%	23-Mar-12
31-Mar-11	Barclays Bank Plc	2,000,000	1.58%	30-Mar-12
	Blackrock Money Market Fund	2,000,000	0.670%	
	Prime Rate Money Market Fund	2,000,000	0.767%	
	Eurobond Fixed Rate	7,537,881		
	Corporate Bond Fixed Rate	5,194,979		
	Eurobond Floating Rate Note	6,000,000		
		38,732,860		

Prudential Indicators – 2010/11

Background:

22. In March 2010, Full Council approved the indicators for 2010/11, as required by the Prudential Code for Capital Finance in Local Authorities. The Local Government Act 2003 allows local authorities to determine their own borrowing limits provided they are affordable and that every local authority complies with the code.

Prudential Indicator 1 - Capital Expenditure:

23. The actual capital expenditure incurred for 2010/11 compared to the original estimate is:

	2009/10 Outturn £'000	2010/11 Original Estimate £'000	2010/11 Outturn £'000	2010/11 Variance £'000	Reason for Variance
Approved capital schemes	6,259	9,301	5,812	(3,489)	Decrease arises from the reprofiling of estimated expenditure in 2010/11 to future years
Total Expenditure	**6,259**	**9,301**	**5,812**	**(3,489)**	

The figures in brackets reflect that actual expenditure was less than budgeted.

Prudential Indicator 2 - Ratio of Financing Costs to Net Revenue Stream:

24. A comparison needs to be made between financing capital costs and the revenue income stream to support these costs. This shows how much of the revenue budget is committed to the servicing of finance.

Portfolio	2009/10 Outturn £'000	2010/11 Original Estimate £'000	2010/11 Outturn £'000	2010/11 Variance £'000	Reason for Variance
Financing Costs	(2,159)	(1,368)	(1,084)	284	Interest rates have stayed lower for longer than anticipated. Minimum Revenue Provision and related interest charges have been charged to the General Fund as a consequence of reclassifying some operating leases to finance leases
Net Revenue Stream	19,765	20,310	20,716	406	The budget has increased due to the approval of the carry forwards from 2009/10
%	**(11.2)**	**(6.7)**	**(5.2)**		

25. The financing costs include interest payable and notional amounts set aside to repay debt less interest on investment income. The figure in brackets is due to investment income outweighing financing costs significantly for SSDC but is nevertheless relevant since it shows the extent to which the Council is dependent on investment income.

Prudential Indicator 3 - Capital Financing Requirement:

26. The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The year-end capital financing requirement for the council is shown below:

	2009/10 Outturn Restated £'000	2010/11 Original Estimate Restated £'000	2010/11 Outturn £'000	2010/11 Variance £'000	Reason for Variance
Opening CFR	9,642	9,461	9,461	(96)	
Capital Expenditure	6,259	9,301	5,812	(3,489)	See explanations for indicator 1 above
Capital Receipts*	(4,270)	(7,116)	(2,734)	4,382	Reduced requirement to draw on Capital receipts due to extra grants being received as well as reprofiling of expenditure to future years
Grants/Contributions*	(1,989)	(2,185)	(3,078)	(893)	Extra income received for gypsy sites and from the Regional Housing Pot
Minimum Revenue Position (MRP)	(181)	(206)	(208)	(2)	
Additional Leases taken on during the year			161	161	
Closing CFR	**9,461**	**9,255**	**9,414**	**136**	

*Figures in brackets denote income through receipts or reserves.

Prudential Indicator 4 – Net external Borrowing compared to the medium term Capital Financing Requirement:

27. The Council is also required to ensure that any medium term borrowing is only used to finance capital and therefore it has to demonstrate that the net external borrowing does not, except in the short term exceed the total of capital financing requirements over a three year period.

	2009/10 Outturn Restated	2010/11 Original Estimate Restated £'000	2010/11 Actual £'000	2010/11 Variance £'000	Reason for Variance
Net Borrowing	(38,188)	(34,802)	(37,936)	(3,134)	More investments than predicted due to the reduced draw on capital receipts
CFR	9,461	9,255	9,414	136	See explanations for indicator 3 above

28. The figures above in brackets described as net borrowing actually represent net investments. Our net borrowing is forecast to remain as net investment for the foreseeable future and therefore will not at any time be in excess of the capital financing requirement.

Prudential Indicator 5 - Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

29. The Council must set three years of upper limits to its exposure to the effects of changes in interest rates. As a safeguard, it must ensure that its limit would allow it to have up to 100% invested in variable rate investments to cover against market fluctuations. For this purpose, term deposits of less than 365 days are deemed to be variable rate deposits. Fixed rate deposits are investments in Eurobonds, Corporate Bonds and term deposits exceeding 365 days.

	2009/10 Actual %	2010/11 % Limit	2010/11 Actual %	2010/11 Variance %	Reason for Variance
Fixed	38.7	80	32.9	(47.1)	Within limit
Variable	61.3	100	67.1	(32.9)	Within limit

30. The Council must also set limits to reflect any borrowing we may undertake.

	2009/10 Actual %	2010/11 % Limit	2010/11 Actual %	2010/11 Variance %	Reason for Variance
Fixed	0	100	0	100	SSDC currently has no borrowing
Variable	0	100	0	100	SSDC currently has no borrowing

31. The indicator has been set at 100% to maximise opportunities for future debt as they arise.

Prudential Indicator 6 - Upper Limit for total principal sums invested over 364 days:

32. SSDC must also set upper limits for any investments of longer than 364 days. The purpose of this indicator is to ensure that SSDC, at any time, has sufficient liquidity to meet all of its financial commitments. The following table summarises the position:

Upper Limit for total principal sums invested over 364 days	2009/10 Actual £'000	2010/11 Maximum Limit £'000	2010/11 Actual £'000	Variance £'000	Reason for Variance
Between 1-2 years	8,604	25,000	3,218	(21,782)	Within limit
Between 2-3 years	3,296	20,000	6,000	(14,000)	Within limit
Between 3-4 years	2,001	10,000	1,174	(8,826)	Within limit
Between 4-5 years	1,160	10,000	0	(10,000)	Within limit
Over 5 years	0	5,000	0	(5,000)	Within limit

33. The table above shows that the Council adopts a policy of safeguarding its investments by minimising investments that are redeemable more than five years ahead.

Prudential Indicator 7 - Actual External Debt:

34. This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities (this represents our finance leases). This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2011	£'000
Borrowing	0
Other Long-term Liabilities	301
Total	**301**

Prudential Indicator 8 - Authorised Limit for External Debt:

35. This limit represents the maximum amount that SSDC may borrow at any point in time during the year. If this limit is exceeded the Council will have acted ultra vires. It also gives the Council the responsibility for limiting spend over and above the agreed capital programme. A ceiling of £12 million was set for each year.

	2009/10 Actual Restated £'000	2010/11 Estimate £'000	2010/11 Actual £'000	2010/11 Variance £'000	Reason for Variance
Borrowing	0	11,450	0	(11,450)	SSDC currently has no borrowing
Other Long-term Liabilities	348	550	301	(249)	Within limit
Total	**348**	**12,000**	**301**	**(11,699)**	

Prudential Indicator 9 – Operational Boundary for External Debt:

36. The operational boundary sets the limit for short term borrowing requirements for cash flow and has to be lower than the previous indicator, the authorised limit for external debt. A ceiling of £10 million for each of the next three years was set.

	2009/10 Actual Restated £'000	2010/11 Estimate £'000	2010/11 Actual £'000	2010/11 Variance £'000	Reason for Variance
Borrowing	0	9,500	0	(9,500)	SSDC currently has no borrowing
Other Long-term Liabilities	348	500	301	(199)	Within limit
Total	**348**	**10,000**	**301**	**(9,699)**	

Prudential Indicator 10 - Maturity Structure of Fixed Rate borrowing:

37. This indicator is relevant when we borrow, then we can take a portfolio approach to borrowing in order to reduce interest rate risk. This indicator is shown as the Council has set limits in anticipation of future borrowing.

Maturity structure of fixed rate borrowing	2010/11 Upper Limit %	2010/11 Lower Limit %	2010/11 Actual %	2010/11 Variance %	Reason for Variance
Under 12 months	100	0	0	Not applicable	
12 months and within 24 months	100	0	0	Not applicable	
24 months and within 5 years	100	0	0	Not applicable	
5 years and within 10 years	100	0	0	Not applicable	
10 years and within 20 years	100	0	0	Not applicable	
20 years and within 30 years	100	0	0	Not applicable	
30 years and within 40 years	100	0	0	Not applicable	
40 years and within 50 years	100	0	0	Not applicable	
50 years and above	100	0	0	Not applicable	

Prudential Indicator 11 - Incremental Impact of Capital Investment Decisions:

38. SSDC must show the effect of its annual capital decisions for new capital schemes on the council taxpayer. Capital spend at SSDC is financed from additional receipts so the figure below actually shows the possible decreases in council tax if all capital receipts were invested rather than used for capital expenditure.

Incremental Impact of Capital Investment Decisions	2009/10 Actual £	2010/11 Original Estimate £	2010/11 Actual £	2010/11 Variance £
Decrease in Band D Council Tax	0.35	0.20	0.11	(0.09)

Prudential Indicator 12 - Adoption of the CIPFA Treasury Management Code:

39. This indicator demonstrates that the Council has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 18th April 2002.

Conclusion

40. The council is currently within all of the Prudential Indicators and is not forecast to exceed them.

Background Papers: *Prudential Indicators Working Paper, Treasury Management Strategy Statement 2010/11*
