Audit Committee – 28th June 2012

5. 2011/12 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 2011/12 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 2011/12 financial year;
- Note the position of the individual prudential indicators for the 2011/12 financial year;
- Note the outlook for the investment performance in 2011/12
- Recommend the 2011/12 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 2011/12

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

strategy was 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). Although Natwest does not meet the minimum credit criteria of A+ (or equivalent) long term, it is the Council's bank and will still be used for operational purposes. Balances of smaller amounts (less than £300,000) will be kept within our Natwest Account to ensure operational and contingency purposes are maintained.

8. From April until early September, where cash-flow permitted the Council followed a cautious investment strategy of a rolling programme of 12 month deposits with named counterparties for a proportion of its investments. Arlingclose have since reduced the limit of new investments on two separate occasions. On the 11th August, Arlingclose reigned in maturity limits to a maximum of 6 months on new investments and again on 11th November to 3 months (as previously reported). The Council maintained a rolling programme of deposits with named counterparties within these restrictions.

9. As previously reported, following the growing problems facing peripheral Europe, the Council responded to the growing stress by scaling back maturities for new investments on the advice of the Council's treasury advisors. Limits for European banks have been temporarily suspended for new investments. Limits for UK banks, Australian, Canadian and US banks have now been temporarily reduced to 3 months except for Santander UK plc which is now restricted to overnight deposits.

   The ratings of most of the UK banks, Nationwide Building Society and non-UK banks were either downgraded or placed on review for possible downgrade. For the UK banks, the downgrades largely reflected the reassessment by the agencies of the extent of future systemic support that would be forthcoming from the sovereign. For Eurozone banks, the worsening sovereign debt crisis and poor growth outlook led to pressure on sovereign ratings and consequently on bank ratings. The downgrades resulted in the long-term rating of several UK institutions (Barclays, NatWest/RBS, Bank of Scotland/Lloyds TSB Bank, Clydesdale Bank and Nationwide BS) falling below the Council's minimum criteria of 'A+'. Even though there are no solvency issues with these institutions, they were temporarily suspended as counterparties for new investments until the new Treasury Management Strategy Statement came into effect from 1st April 2012 as approved by full Council in February 2012.

10. The sum invested in longer dated securities at fixed rates of interest at the end of March represented 18.5% of the total portfolio. The sum invested in longer dated securities at variable rates of interest at the end of March represented 15.4% of the total portfolio. Investments made in longer dated securities comprise EuroSterling bonds and World bonds; these investments have all been made in conjunction with advice from our treasury advisors, Arlingclose.

11. The Treasury Management Strategy Statement and Annual Investment Policy were both approved by Council on 17th March 2011. 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%

12. The table below compares the investment portfolio at 31st March 2012 to the investment strategy:-

	£'m	%	**Strategic aim**
Pooled Managed Funds and business reserve accounts	3.71	9.53	0% - 25%
Term deposits (up to 2 year)	22.00	56.54	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/World Bonds.	13.20	33.93	10% - 75%
	38.91		

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

Interest Rates 2011/12

13. Base rate began the financial year at 0.5% and this has been maintained throughout 2011/12.

14. Our advisors are forecasting that the outlook is for official interest rates to remain low for an extended period, as shown below:

	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Official Bank Rate													
Upside risk				0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Central case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk		-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25

Investment Portfolio

15. The table below shows the Council's portfolio of investments at the start and end of the 2011/12 financial year;

	Value of Investments at 01.04.11 £	Value of Investments at 31.03.12 £	Fixed/ Variable Rate
Investments advised by Arlingclose			
Euro Sterling Bonds	7,537,881	4,182,407	Fixed
Corporate Bonds	5,194,979	0	Fixed
World Bonds	0	3,035,190	Fixed
Treasury Bills	0	0	Variable
Euro Sterling Bonds	6,000,000	5,985,000	Variable
Total	**18,732,860**	**13,202,597**	
Internal Investments			
Short Term Deposits (Banks)	16,000,000	8,000,000	Variable
Short Term Deposits (Other LAs)		14,000,000	Variable
Short Term Deposits (DMADF)		0	Variable
Money Market Funds & Business Reserve Accounts	4,000,000	3,710,000	Variable
Total	**20,000,000**	**25,710,000**	
TOTAL INVESTMENTS	**38,732,860**	**38,912,597**	

Returns for 2011/12

16. The returns to 31st March 2012 are shown in the table below:

	Actual Income £'000	% Rate of Return
Investments advised by Arlingclose		
Euro Sterling Bonds (Fixed)	395	
Corporate Bonds	140	
World Bonds	9	
Treasury Bills	1	
Euro Sterling Bonds (Variable)	53	
Total	**598**	**3.06%**
Internal Investments		
Short Term Deposits	314	
Money Market Funds & Business Reserve Accounts	55	
Total	**369**	**1.15%**
Other Interest		
Miscellaneous Loans	52	
Total	**52**	

TOTAL INCOME TO 31st MARCH 2012	**1,019**	**1.81%**
PROFILED BUDGETED INCOME	**800**	
SURPLUS	**219**	

17. The table above shows investment income for the year compared to the profiled budget. The figures show a surplus over budget of £219,000.

18. Following the crisis in the eurozone we have sold some of our Eurobonds on the advice of Arlingclose. This has contributed towards the surplus in the current financial year but will have an effect on next financial year's estimates. This will result in us having to draw on the Treasury Management Reserve should there be any shortfall.

19. 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 the collection of council tax and business rate.

20. The original Treasury Management budget of £799,620 was derived by forecasting an average rate of return of 1.78%. The actual interest rate received for the year was 1.81%.

Investments

21. The graph shown in appendix B shows the performance of the in-house Treasury team in respect of all investments for the quarter ending 31st March 2012 in comparison to all other clients of Arlingclose.

22. The graph shows that SSDC is in a very good position in terms of the risk taken against the return on investments.

Borrowing

23. An actual overall borrowing requirement (CFR) of £9.4 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 2012 the Council had no external borrowing.

Prudential Indicators – 2011/12

Background:

24. In March 2011, Full Council approved the indicators for 2011/12, 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:

25. The actual capital expenditure incurred for 2011/12 compared to the original estimate is:

	2010/11 Outturn £'000	2011/12 Original Estimate £'000	2011/12 Outturn £'000	2011/12 Variance £'000	Reason for Variance
Approved capital schemes	5,812	5,341	3,837	(1,504)	The variance is due to slippage within the capital programme from 2011/12 to future years. The 5 largest projects being: Birchfield Sewer Pollution Easement Works (£188k), Enhancements to Princes St - Phase II Implementation (£110k), Reckleford Gyratory (Eastern Gateway) (£97k), Yeovil Crematorium (£94k) and Disabled Facilities Grants (£85k)
Capital Investments	0	0	(5,000)	(5,000)	Corporate Bond Matured in November 2011
Total Expenditure	**5,812**	**5,341**	**(1,163)**	**(6,504)**	

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

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

26. 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	2010/11 Outturn £'000	2011/12 Original Estimate £'000	2011/12 Outturn £'000	2011/12 Variance £'000	Reason for Variance
Financing Costs	(1,084)	(674)	(801)	(127)	Increased income on investments and a gain on selling some Eurobonds within the year.
Net Revenue Stream	20,716	17,345	17,861	516	Carry Forwards approved from 2010/11 and incorporated within the budget for 2011/12
%	**(5.2)**	**(3.9)**	**(4.5)**		

27. 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:

28. 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:

	2010/11 Outturn £'000	2011/12 Original Estimate £'000	2011/12 Outturn £'000	2011/12 Variance £'000	Reason for Variance
Opening CFR	9,461	9,415	9,415	0	
Capital Expenditure	5,812	5,341	3,837	(1,504)	See Prudential Indicator 1 above.
Capital Receipts*	(2,734)	(3,971)	(2,706)	1,265	Due to the reduction in capital spend in 2011/12, financing through capital receipts was reduced.
Grants/ Contributions*	(3,078)	(1,370)	(1,131)	239	
Minimum Revenue Position (MRP)	(208)	(126)	(177)	(51)	Additional leases have incurred additional MRP
Additional Leases taken on during the year	162		268	268	New leases relating to 5 x Multi functional Devices, 5 x ride on mowers and 7 x Tippers (Vehicles)
Closing CFR	**9,415**	**9,289**	**9,506**	**217**	

*Figures in brackets denote income through receipts or reserves.

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

29. 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.

	2010/11 Outturn £'000	2010/11 Quarter 3 Actual £'000	2011/12 Outturn £'000	2011/12 Variance £'000	Reason for Variance
Net Borrowing	(37,936)	(46,434)	(39,551)	6,883	The actual was used as an estimate for 2011/12. This estimate was based on 2010/11 quarter 3 balances which reduced in February and March due to no council tax collection but payments being made to the major preceptors
CFR	9,415	9,289	9,506	217	See explanations for indicator 3 above

30. 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:

31. 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.

	2010/11 Actual %	2011/12 % Limit	2011/12 Actual %	2011/12 Variance %	Reason for Variance
Fixed	32.9	80	18.6	(61.4)	Within limit
Variable	67.1	100	81.4	(18.6)	Within limit

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

	2010/11 Actual %	2011/12 % Limit	2011/12 Actual %	2011/12 Variance %	Reason for Variance
Fixed	0	100	0	100	SSDC currently has no borrowing
Variable	0	100	0	100	SSDC currently has no borrowing

33. 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:

34. 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	2010/11 Actual £'000	2011/12 Maximum Limit £'000	2011/12 Actual £'000	Variance £'000	Reason for Variance
Between 1-2 years	3,218	25,000	9,020	(15,980)	Within limit
Between 2-3 years	6,000	20,000		(20,000)	Within limit
Between 3-4 years	1,174	10,000		(10,000)	Within limit
Between 4-5 years		10,000		(10,000)	Within limit
Over 5 years		5,000		(5,000)	Within limit

35. 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:

36. 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 31/03/2012	£'000
Borrowing	0
Other Long-term Liabilities	389
Total	**389**

Prudential Indicator 8 - Authorised Limit for External Debt:

37. 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.

	2010/11 Actual £'000	2011/12 Original Estimate £'000	2011/12 Actual £'000	2011/12 Variance £'000	Reason for Variance
Borrowing	0	11,000	0	(11,000)	SSDC currently has no borrowing
Other Long-term Liabilities	301	1,000	389	(611)	Within limit
Total	**301**	**12,000**	**389**	**(11,611)**	

Prudential Indicator 9 – Operational Boundary for External Debt:

38. 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.

	2010/11 Actual £'000	2011/12 Original Estimate £'000	2011/12 Actual £'000	2011/12 Variance £'000	Reason for Variance
Borrowing	0	9,200	0	(9,200)	SSDC currently has no borrowing
Other Long-term Liabilities	301	800	389	(411)	Within limit
Total	**301**	**10,000**	**389**	**(9,611)**	

Prudential Indicator 10 - Maturity Structure of Fixed Rate borrowing:

39. 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	2011/12 Upper Limit %	2011/12 Lower Limit %	2011/12 Actual %	2011/12 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:

40. 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	2010/11 Actual £	2011/12 Original Estimate £	2011/12 Actual £	2011/12 Variance £
Decrease in Band D Council Tax	0.11	0.20	0.20	0

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

41. 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

42. 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 2011/12*