BRECKLAND DISTRICT COUNCIL

Report of Mark Finch, Assistant Director Finance

To: Audit Committee 15th June 2012

Author: Mark Finch, Assistant Director of Finance

Subject: Annual Report on the Treasury Management Service and Actual Prudential Indicators 2011/12

Purpose:
This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2011/12. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

Recommendations:
Audit Committee is recommended to:
1.0 Approve the actual 2011/12 prudential indicators within this report
2.0 Note the Treasury Management stewardship report for 2011/12 at Appendix B and Appendix C

1.0 BACKGROUND

During 2011/12 the minimum reporting requirements were that Audit Committee should receive the following reports:

- an annual treasury strategy in advance of the year (Audit Committee 14/1/2011)
- a mid year (minimum) treasury update report (Audit Committee 25/11/2011)
- an annual review following the end of the year describing the activity compared to the strategy (this report)

Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

Member training on treasury management issues was undertaken during the year on 30/09/2011 in order to support members' scrutiny role.

An update from Sector, the Councils Treasury management Advisors, on the economy and interest rates is attached at Appendix A.

2.0 Overall Treasury Position as at 31st March 2012

During 2011/12, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2010/11 Actual £000	2011/12 Original £000	2011/12 Actual £000
Actual capital expenditure	6,351	3,193	2,074

Actual prudential and treasury indicators	2010/11 Actual £000	2011/12 Original £000	2011/12 Actual £000
Capital Financing Requirement (CFR):	Nil	Nil	Nil
Net borrowing	Nil	Nil	Nil
External debt	Nil	Nil	Nil
Investments • Longer than 1 year • Under 1 year • Total	 4,168 28,872 33,040	n/a	 3,303 28,185 31,488

NB – total includes £4,846k Iceland and £16,546k instant access cash as at 31st March (subject to change due to cashflow)

Other prudential and treasury indicators can be found at Appendix B. The Assistant Director of Finance also confirms that no borrowing was undertaken for a capital purpose and the statutory borrowing limit (the authorised limit), was not breached.

The financial year 2011/12 continued the challenging investment environment of previous years, namely low investment returns and continued heightened levels of counterparty risk.

At 31 March 2012, the Council's external debt was Nil (Nil at 31 March 2011) and its investments totalled £31.49m (£33.04m at 31 March 2011). £4.8m of the investment balance is money held on behalf of Moving Thetford Forward and £4.846m relates to Icelandic balances awaiting repayment.

3.0 OPTIONS

3.1 To approve the actual 2011/12 prudential indicators within the report and the treasury management stewardship report for 2011/12.

3.2 Not to approve the actual 2011/12 prudential indicators within the report and the treasury management stewardship report for 2011/12 as presented and make changes

4.0 REASONS FOR RECOMMENDATION

To meet the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities

5.0 EXPECTED BENEFITS

The Council is required through regulation to report the outturn position for last year. By approving the outturn report, this will ensure the Council has confirmed compliance with regulations and has identified the starting position for treasury activity in the forthcoming year.

6.0 IMPLICATIONS

6.1 **Legal –** Local Government Act 2003

7.0 OTHER IMPLICATIONS

a) Equalities: No – Implicit within process

b) Section 17, Crime and Disorder Act 1998: None

c) Section 40, natural Environment & Rural Communities Act 2006: None

d) Human resources: None

e) Human Rights: None

f) Other: None

8.0 **Risk** I have completed the risk management questionnaire and I can confirm that risk has been given careful consideration and that there are no significant risks identified associated with the information in this report

9.0 **Financial** The report is of a financial nature and the financial implications are included within the report

10.0 Stakeholders / Consultation

There is no consultation associated with this report as it is of a financial/internal performance nature

11.0 Contracts

There are no contracts associated with this report

12.0 ALIGNMENT TO COUNCIL PRIORITIES

12.1 The Treasury Policy and Strategy are aligned to the Council priorities

13.0 WARDS/COMMUNITIES AFFECTED

13.1 This report is an internal performance report and therefore does not affect any wards/communities directly

Background papers:-

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Key Decision – Yes

Appendices attached to this report:

Appendix A – The economy and interest rates
Appendix B - Annual Report on the Treasury Management Service 2011/12 (Incorporating Outturn Prudential Indicators)
Appendix C – March 2012 Treasury Performance Report

Appendix A

The Economy and Interest Rates

The financial year 2011/12 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2011-12 was that Bank Rate would start gently rising from quarter 4 2011. However, economic growth in the UK was disappointing during the year under the weight of the UK austerity programme, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the European Union (EU). The UK coalition Government maintained its aggressive fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA rating. Key to retaining this rating will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within the austerity plan timeframe. The USA and France lost their AAA ratings from one rating agency during the year. Weak UK growth resulted in the Monetary Policy Committee increasing quantitative easing by £75bn in October and another £50bn in February. Bank Rate therefore ended the year unchanged at 0.5% while CPI inflation peaked in September at 5.2% but then fell to 3.4% in February, with further falls expected to below 2% over the next two years. The EU sovereign debt crisis grew in intensity during the year until February when a second bailout package was eventually agreed for Greece.

Gilt yields fell for much of the year, until February, as concerns continued building over the EU debt crisis. This resulted in safe haven flows into UK gilts which, together with the two UK packages of quantitative easing during the year, combined to depress PWLB rates to historically low levels.

Investment rates. Risk premiums were also a constant factor in raising money market deposit rates for periods longer than 1 month. Widespread and multiple downgrades of the ratings of many banks and sovereigns, continued Eurozone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment.

Appendix B

Annual Report on the Treasury Management Service 2011/12 (Incorporating Outturn Prudential Indicators)

1.0 Introduction and background

1.1 This report summarises:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

2.0 The Council's Capital Expenditure and Financing 2011/12

2.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

2.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m	2010/11 Actual £000's	2011/12 Estimate £000's	2011/12 Actual £000's
Non-HRA capital expenditure	6,351	3,193	2,074
HRA capital expenditure	Nil	Nil	Nil
Total capital expenditure	**6,351**	**3,193**	**2,074**
Resourced by:			
• Capital reserves	5,677	2,387	1,595
• Capital grants	674	806	403
• Other reserves	0	0	76
Total capital resourced	**6,351**	**3,193**	**2,074**

3.0 The Council's overall borrowing need

3.1 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge of the Council's capital borrowing need. The Council does not currently have a positive CFR, and so has no underlying need to borrow for a capital purpose.

3.2 The Council's 2011/12 Minimum Revenue Provision (MRP) Policy (as required by Communities & Local Government (CLG) Guidance) was approved as part of the Treasury Management Strategy Report for 2011/12 on 14th January 2011.

3.3 The Council's CFR for the year is shown below, and represents a key prudential indicator. This includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract. The Council has complied with this prudential indicator.

	31 March 2011 **Actual**	**31 March 2012** **Original Indicator**	**31 March 2012** **Actual**
Net borrowing position	**(£33.04m)**	**(£21.00m)**	**(£31.49m)**
CFR	**£0m**	**£0m**	**£0m**

3.4 Net borrowing represents the Investment balance at 31st March 2012.

3.5 **The authorised limit** - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2011/12 the Council has maintained gross borrowing within its authorised limit.

3.6 **The operational boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

3.7 **Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2011/12
Authorised limit	£10.660m
Maximum gross borrowing position	£0
Operational boundary	£0
Average gross borrowing position	£0
Financing costs as a proportion of net revenue stream	(4.63%)

4.0. Treasury Position as at 31 March 2012

4.1 The Council's debt and investment position is organised to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2011/12 the Council's treasury position was as follows:

Actual borrowing position	31 March 2011		31 March 2012	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	£0.00m		£0.00m	
Variable Interest Rate Debt	£0.00m		£0.00m	
Total Debt	**£0.00m**		**£0.00m**	
Capital Financing Requirement	**£0m**		**£0m**	
Over/(Under) borrowing	**-**		**-**	
Investment position	**31 March 2011**		**31 March 2012**	
	Principal £000's	**Average Rate**	**Principal £000's**	**Average Rate**
Fixed Interest Investments	£18,215		£14,942	
Variable Interest Investments	£14,825		£16,546	
Total Investments	**£33,040**	**2.30%**	**£31,488**	**1.96%**
Net borrowing position	**£(33,040)**		**£(31,488)**	

4.2 During 2011/12 the Assistant Director of Finance managed the debt position at nil. All investments were for less than 1 year.

5. The Strategy for 2011/12

5.1 The expectation for interest rates within the strategy for 2011/12 anticipated low but rising Bank Rate (starting in quarter 4 of 2011) with similar gradual rises in medium and longer term fixed interest rates over 2011/12. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns.

5.2 Change in strategy during the year
There are no changes to Strategy during 2011/12 that have not previously been reported.

6.0 Investment Rates in 2011/12 (Sector narrative)

6.1 The tight monetary conditions following the 2008 financial crisis continued through 2011/12 with little material movement in the shorter term deposit rates. However, one month and longer rates rose significantly in the second half of the year as the Eurozone crisis grew. The ECB's actions to provide nearly €1 trn of 1% 3 year finance to EU banks eased liquidity pressures in the EU and investment rates eased back somewhat in the quarter 1 of 2012. This action has also given EU banks time to strengthen their balance sheets and liquidity positions on a more permanent basis. Bank Rate remained at its historic low of 0.5% throughout the year while market expectations of the imminence of the start of monetary tightening was gradually pushed further and further back during the year to the second half of 2013 at the earliest..

Overlaying the relatively poor investment returns were the continued counterparty concerns, most evident in the Euro zone sovereign debt crisis which resulted in a second rescue package for Greece in quarter 1 2012. Concerns extended to the potential fallout on the European banking industry if the crisis could have ended with Greece leaving the Euro and defaulting.

7.0 Actual debt management activity during 2011/12

7.1 The Council did not undertake any borrowing in 2011/12 therefore there was no specific debt management required

8.0 Investment Outturn for 2011/12

8.1 **Investment Policy** – the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 14/1/2011 (updated in mid yr report 25/11/2011). This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market information. Due to the limited counterparty options, an alternative was presented to Audit Committee on 23/3/2012 but the Committee chose to continue with it's current approach to counterparty selection based solely on credit ratings. Other options for investment opportunities continue to be explored.

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

9.3 **Resources** – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources (£000's)	31 March 2011	31 March 2012
Balances	**4,080**	**2,581**
Earmarked reserves	**8,277**	**10,420**
Provisions	**(297)**	**(297)**
Usable capital receipts	**0**	**0**
Total	**12,060**	**12,704**

9.4 **Investments held by fund managers** - The Council has no funds with Fund managers. All investments are managed internally

9.5 **Investments held by the Council** - the Council maintained an average balance of £32m of internally managed funds (of which £4.8m is money held on behalf of Moving Thetford Forward and £4.846m relates to Icelandic balances awaiting repayment. The internally managed funds earned an average rate of return of 1.96%. The comparable performance indicator is the average 3month LIBID rate which was 0.90%. This compares with a budget assumption of £17m investment balances (which excludes Icelandic & Moving Thetford Forward balances) earning an average rate of 1.348%

10.0 Performance Measurement

10.1 This service has set the following performance indicators and operated within the boundaries set as detailed in the March performance report attached at Appendix C:

- Security

  Risk of default

  Average Weighted Life

  To measure the risk level associated with the Council's portfolio of investments.

- Liquidity

  Instant access cash – The Council requires an average balance of £5m instant access cash to be available at any time

  Bank Overdraft – The Council's approved overdraft facility is £1m

- Yield

  3 month LIBID

  Actual interest earned against budget

11.0 Icelandic Bank Defaults

11.1 This authority currently has investments frozen in Icelandic banks. The carrying amounts of the Council's claim on the banks at 31st March 2012 is £4,845,658.

11.2 All monies within these institutions are currently subject to the respective administration and receivership processes. The amounts and timing of payments to depositors such as the authority will be determined by the administrators / receivers. The current situation with regards to recovery of the sums deposited varies between each institution. Members will be periodically updated on the latest developments on these efforts.