ITEM NO.16

REPORT TO THE COUNCIL MEETING OF 30 July 2012

Status:	**Decision**
Title:	**Annual Treasury Management Report and Actual Prudential Indicators 2011/12**
Originator:	**Jim Holden, Shared Section 151 Officer**
Where from:	**Corporate Management Team**
Where to next:	

1 Purpose of the Report

1.1 The annual treasury report is a requirement of the Council's reporting procedures, and covers the treasury activity for 2011/12. The report also covers the actual Prudential Indicators for 2011/12 in accordance with the requirements of the Prudential Code.

2 Recommendations:

2.1 That Council approve the actual Prudential Indicators for 2011/12.

2.2 That Council note the Annual Treasury Management Report for 2011/12.

3 Summary of Reasons for the Recommendations:

3.1 It is a requirement of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management in Local Authorities that an Annual Treasury Report be brought before Council within six months of the end of the financial year in question.

3.2 The Prudential Code for Capital Finance in Local Authorities, introduced on 1 April 2004, requires that the Council approves the actual Prudential Indicators after the end of the financial year.

4 Impact on Communities

4.1 None as far as this report is concerned.

5 Key Facts

5.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance, primarily the Local Government Act 2003 (the Act) which provides the powers to borrow and invest as well as providing controls and limits on this activity. The Act permits the Secretary of

State to set limits either on individual authorities or nationally on all authorities, which restrict the amount of borrowing which may be undertaken. No such restrictions were put in place during 2011/12. Statutory instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act. The SI requires the Council to undertake any borrowing activity with regard to CIPFA's Prudential Code for Capital Finance in Local Authorities, and to operate its treasury function in line with guidance laid down in CIPFA's Code of Practice for Treasury Management in the Public Services. Under the Act, the Government has also issued investment guidance in order to structure and regulate the Council's investment activities.

5.2 The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector (the Code) and operates its treasury management service in compliance with this Code and the above requirements. The prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable manner.

5.3 The main requirements of the Code are the:

- Creation and maintenance of a Treasury Management Policy Statement setting out the policies and objectives of the Council's treasury management activities;
- Creation and maintenance of Treasury Management Practices which set out the manner in which the Council aims to achieve those policies and objectives;
- Production of an Annual Treasury Strategy Report which covers the forecast activity for the forthcoming financial year;
- Production of an Annual Treasury Management Report which reviews actual activity on the treasury function for the preceding financial year.

5.4 The Prudential Code requires the Council to set prudential indicators which provide a framework for capital expenditure decision making. It highlights through the prudential indicators the level of capital expenditure, the impact on borrowing and investment levels and the overall controls in place to ensure the activity remains affordable, prudent and sustainable. Within the overall capital expenditure framework there is a clear impact on the Council's treasury management activity, either through increased borrowing levels or the application of investment balances.

5.5 During 2011/12 the Council complied with its legislative and regulatory requirements. The actual prudential indicators for the year, with comparators, are as follows:

Actual Prudential Indicators	**2010/11 £000**	**2011/12 £000**
Actual capital expenditure	4,400	2,600
Capital Financing Requirement:	2,149	2,110

Financing costs as a proportion of net revenue stream	2.12%	2.39%

The 2011/12 Capital Financing Requirement (CFR) of £2.1m was below the approved indicator figure of £3.3m.

5.6 The Shared Section 151 Officer also confirms that borrowing was only undertaken for a capital purpose and that the statutory borrowing limit, the Authorised Limit, was not breached.

5.7 At 31 March 2012, the Council's external debt was £1.49m (£1.49m at 31 March 2011), and the total of investments were £7.6m, including £3.6m shown as cash equivalents (previous year £4.1m).

6. Capital Expenditure and Financing

6.1 The Council undertakes capital expenditure on long term assets and these activities may be financed immediately through capital receipts, capital grants etc. If, however, insufficient financing is available from these sources, or a decision is taken not to apply capital resources, the expenditure will give rise to a borrowing need.

6.2 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or by utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then to optimise performance. Wider information on the regulatory requirements is shown in paragraph 14.

6.3 The actual capital expenditure forms one of the required prudential indicators, and the following table shows how much was spent and how it was financed.

	2010/11 Actual £000	**2011/12 Estimate £000**
Total capital expenditure	4,400	2,600
Financed by:		
Capital receipts	(361)	(33)
Capital grants	(323)	(261)
Other external contributions	(3,260)	(1,707)
Revenue	(192)	(396)
Unfinanced capital expenditure (additional need to borrow)	**264**	**203**

7. The Council's Overall Borrowing Need

7.1 The Council's underlying need to borrow is known as the Capital Financing Requirement (CFR). The CFR is a gauge of the Council's debt position. It represents the level of capital expenditure for 2011/12 and earlier years which has not yet been paid for by revenue or other resources.

7.2 The CFR is reduced each year by an appropriate revenue charge. This is calculated under the Council's adopted policy, to repay borrowing over the anticipated life of the assets being financed. The total CFR may also be reduced by the application of additional capital resources such as unapplied capital receipts.

7.3 The Council's CFR for the year is shown below, and represents a key prudential indicator. (Note the approved indicator used an estimated opening position).

Capital Financing Requirement	**31 March 2012 Actual Indicator £000**	**31 March 2012 Approved Indicator £000**
Opening balance as at 1 April 2011	2,149	2,977
Add unfinanced capital expenditure	203	681
Less: Revenue Provision	(242)	(322)
Closing balance as at 31 March 2012	**2,110**	**3,336**

8. <u>The Treasury Position at 31 March 2012</u>

8.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Deputy Chief Executive could manage the Council's actual borrowing position by either borrowing to the CFR, choosing to utilise some temporary cash flow funds instead of borrowing (under-borrowing), or borrowing for future increases in the CFR (borrowing in advance of need).

8.2 It should be noted that the accounting practice required to be followed by the Council, are contained in the Statement of Recommended Practice (SoRP). Under these requirements, financial instruments in the accounts (debt, investments etc) have to be measured using a method compliant with national Financial Reporting Standards. The figures in this report are based on the amounts borrowed and invested and so may differ from those in the Statement of Accounts which includes items such as accrued interest.

8.3 The treasury position at 31 March 2012 compared with the previous year was:

	31 March 2011		**31 March 2012**	
	Principal £000	**Average Rate**	**Principal £000**	**Average Rate**
Fixed Interest Rate Debt	1,490	5.01%	1,490	5.01%
Variable Interest Rate Debt	0		0	
Total Debt	**1,490**		**1,490**	
Fixed Interest Investments	6,135	0.57%	7,650	0.62%
Variable Interest Investments	0		0	

Total Investments	**6,135**		**7,650**		
Net Borrowing Position	**(4,645)**		**(6,160)**		

9. Prudential Indicators and Compliance Issues

9.1 Some of the required prudential indicators provide either an overview or specific limits on treasury activity. These are shown below.

9.2 Net Borrowing and the CFR – in order to ensure that borrowing levels are prudent, over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Therefore, except in the short term net borrowing should not exceed the CFR for 2011/12 plus the expected changes to the CFR over 2012/13 and 2013/14. The table below highlights that the Council has complied with this requirement.

	31 March 2012 Actual Indicator £000	**31 March 2012 Approved Indicator £000**
Net borrowing position	**(6,160)**	**(1,510)**
Capital Financing Requirement	**2,110**	**3,336**

9.3 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 in paragraph 8.5 demonstrates that during 2011/12 the Council has maintained gross borrowing within its Authorised Limit.

9.4 The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

9.5 The table below compares the Council's maximum and minimum gross borrowing position with the Authorised Limit and Operational Boundary.

	2011/ 12 £000
Approved Indicator - Authorised Limit	4,500
Approved Indicator - Operational Boundary	4,500
Maximum gross borrowing position during the year	1,490
Minimum gross borrowing position during the year	1,490

9.6 Another mandatory indicator shows the ratio of financing costs as a proportion of the net revenue stream. This identifies the trend in the cost of capital (borrowing and other long term obligations net of investment income) against income from government grants, council tax etc. The table compares the actual ratio with the latest approved indicator.

	2011/ 12 Actual Indicator	**2011/12 Approved Indicator**
General Fund	2.39%	3.51%

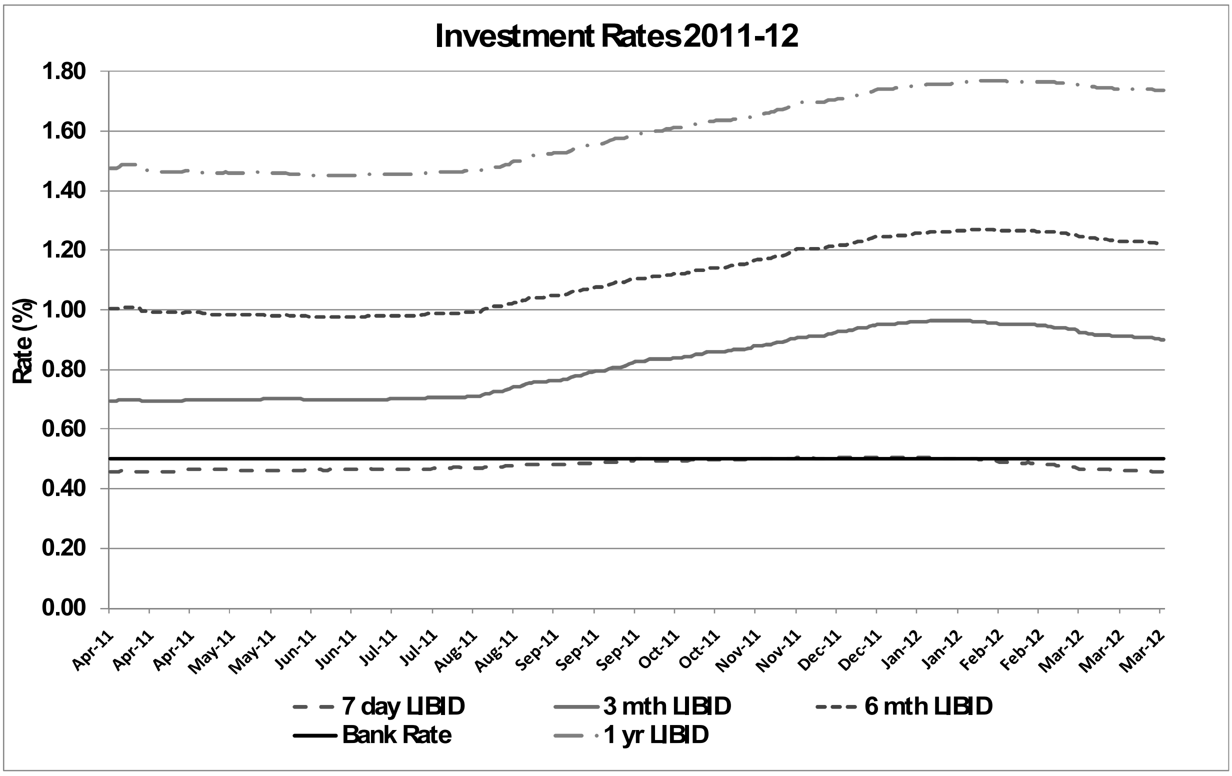
10. Economic Background for 2011/12

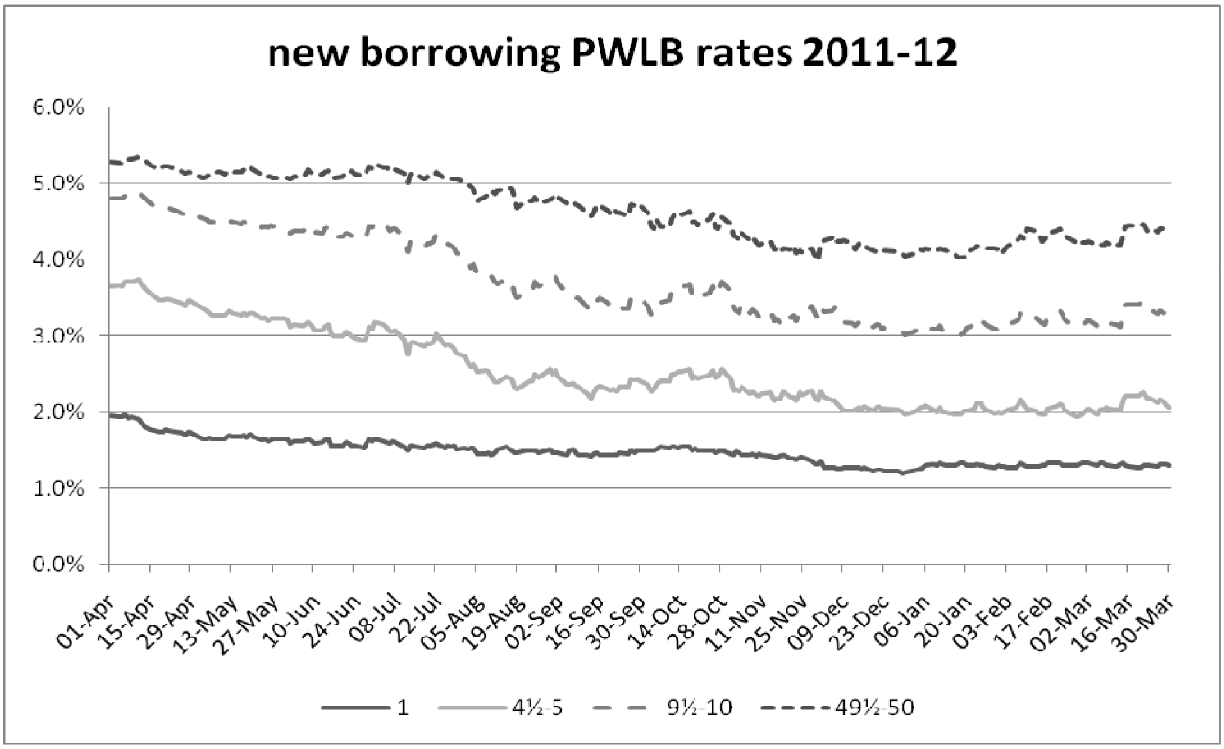
10.1 The original expectation for 2011/12 was that Bank Rate would start gently rising from quarter 4 2011. However, economic growth (GDP) in the UK was disappointing during the year due to the UK austerity programme, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the European Union (EU). The EU sovereign debt crisis grew in intensity during the year until February when a refinancing package was eventually agreed for Greece. This 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%, finishing at 3.5% in March, with further falls expected to below 2% over the next two years.

10.2 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 QE during the year, combined to depress PWLB rates to historically low levels.

10.3 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 credit ratings of many banks and sovereigns, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment

10.4 The UK coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit 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.





11. <u>The Strategy Agreed for 2011/12</u>

11.1 The annual Prudential Code and Treasury Management Strategy for 2011/12 was reported to Council on 24 February 2011. Within that report, the Deputy Chief Executive set out the strategies to be adopted in respect of borrowing and investments over the financial year.

11.2 Borrowing

Long-term fixed interest rates were expected to be at risk of being higher over the medium term, and short-term rates were expected to rise. The Deputy Chief Executive, under delegated powers, undertook to take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account risk. It was felt that shorter term fixed rates would provide lower cost opportunities in the short/medium term.

11.3 Investments

Short term rates were expected to remain on hold so it was considered likely that where appropriate, investment decisions would be made for longer periods with fixed investments rates to lock in good value and security of return if opportunities arose. The Deputy Chief Executive, under delegated powers, would undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks in the interest rate forecast for the year.

12. Actual Debt Management Activity in 2011/12

12.1 At 31 March 2012 the Council is £0.6m under-borrowed – this represents the difference between the CFR and actual long term borrowing.

12.2 Overall the debt activity during the year resulted in no change in the average interest rate of 5.01 per cent as at 31 March 2011 and 31 March 2012.

12. Investments 2011/12

13.1 The Council's investment policy is governed by CLG guidance which has been implemented in the annual investment strategy approved by Council on 24 February 2011. The investment activity during the year conformed to the approved strategy, and the Council experienced no liquidity difficulties.

13.2 The average investment balance maintained during 2011/12 was £13.8 million. It should be stressed that this does not all represent core funds available for investment but also includes short term cash flow balances. The average rate of return on investments was 0.62 per cent. The comparable performance indicator is the average 7 day LIBID rate which was 0.48 per cent.

13.3 In the following table the results of the investment strategy undertaken by the Council are shown.

	Average Investment £000	Interest Earned £000	Rate of Return	Benchmark Return *
Bank	1,028	3	0.25%	
Money Market	12,805	83	0.65%	
Overall	13,833	86	0.62%	0.48%

* - the benchmark is taken to be the 7 day LIBID rate (uncompounded) sourced from data provided by Sector, the Council's treasury advisors.

No institutions in which investments were made showed any difficulty in repaying investments and interest in full during the year.

14. Performance Indicators 2011/12

14.1 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. The following indicators apply to this service:

Debt: Average Rate of Borrowing for the year	2011/12 Actual Rate	2011/ 12 Average Available Rate
Loan raised in year	**0**	**0**

Debt: Average Rate	31 March 2011	31 March 2012	Movement (+/-)
PWLB Loans	**5.01%**	**5.01%**	**0%**

Investments: Average Return	2011/12 Actual Rate	2011/12 7 day LIBID Rate
Internally Managed Funds	**0.62%**	**0.48%**

15. Regulatory Framework, Risk and Performance

15.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2011/12);

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;

- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;

- Under the Act the DCLG has issued Investment Guidance to structure and regulate the Council's investment activities;

- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on the approach to Revenue Provision for Loan Repayment was issued under this section on 8 November 2007.

15.2 The Council has complied with all of the relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

15.3 With the support of Sector, the Council's advisers, Council officers proactively manage its debt and investments over the year. The Council has where possible used historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are fixed, utilising long-term loans.

15.4 Shorter-term rates and likely future movements in these rates predominantly determine the Council's investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult, especially in the current economic climate.

16. <u>Legal Issues</u>

16.1 None arising directly from this report.

17. <u>Resource Issues</u>

17.1 Resource issues are implicit within the body of this report.

18. <u>Equality Implications</u>

18.1 None arising directly from this report.

19. Impact on the Organisation

19.1 The Treasury Management function is an important element of the Council's overall financial affairs. It is inextricably linked to any financial decision which the Council may take, both in revenue and capital terms, and has taken on an even greater importance following the introduction of the Prudential Code.

20. Community Safety Implications

20.1 None as far as this report is concerned.

21. Carbon Management Implications

21.1 None as far as this report is concerned.

22. Risk Management Implications

22.1 None as far as this report is concerned.

23. Consultation

23.1 The Treasury Policy and Strategy are devised in partnership with the Council's Treasury Consultants, Sector, who can draw on a wide range of economic and market data. Many of the major treasury decisions taken on matters such as premature debt repayment and debt rescheduling are made taking into account advice received from Sector.

24. Options Considered

24.1 The production of this report to members is a requirement of CIPFA's Code of Practice for Treasury Management in the Public Services, and the Prudential Code.

25. Background Papers

25.1 Final accounts working papers, loans and investment records held by Finance Services.

Previous report(s): None.

Information Issued Under Sensitive Issue Procedure: No

Ward Members Notified: ***N***

Appendices: None