MEETING:	**AUDIT COMMITTEE**
DATE:	**29 SEPTEMBER 2011**
TITLE:	**TREASURY MANAGEMENT 2010/11**
PURPOSE:	**CIPFA's Code of Practice requires that a report on the results of the Council's actual treasury management is produced.**
RECOMMENDATION:	**RECEIVE THE REPORT FOR INFORMATION**
AUTHOR:	**DAFYDD L EDWARDS, HEAD OF FINANCE**

Executive Summary

During 2010/11 the Council's borrowing remained well within the limits originally set, total interest received on deposits was £734,412 marginally below the budgeted level of £799,640. There were no new defaults by banks in which the Council deposited money.

1. Introduction and Background

CIPFA's revised Code of Practice on Treasury Management was adopted by the Council on 1st March 2011 and the Council fully complies with its requirements. The Code requires that I report on the results of the Council's actual treasury management in the previous financial year against that which was expected. It is considered that the Audit Committee is the appropriate body to consider this report.

This report compares our actual performance for 2010/11 against the strategy which was set out in February 2010 for the financial year (approved by the full Council at its meeting on 25/02/2010). The report looks at:

- the economic background;
- the borrowing requirement and debt management;
- investment activity; and
- compliance with Prudential Indicators.

2. Economic Background

At the time of determining the strategy for 2010/11, interest rates were expected to remain low in response to the fragile state of the UK economy. Spending cuts and tax increases seemed inevitable post the General Election. The outlook for growth was uncertain due to consumers and corporates trimming their spending and financial institutions exercising restraint in new lending.

The economy's two headline indicators moved in opposite directions – growth was lacklustre whilst inflation spiked sharply higher. The economy grew by just 1.3% in calendar year 2010; the forecast for 2011 was revised down to 1.7% by the Office of Budget Responsibility in March. Higher commodity, energy and food prices and the increase in VAT to 20% pushed the February 2011 annual inflation figure to 4.4%. The Bank Rate was held at 0.5% as the economy grappled with uneven growth and the austerity measures set out in the coalition government's Comprehensive Spending Review. Significant cuts were made to public expenditure, in particular local government funding.

The US Federal Reserve kept rates on hold at 0.25% following a slowdown in American growth. The European Central Bank maintained rates at 1%, with the markets expecting a rate rise in early Spring.

The credit crisis migrated from banks to European sovereigns. The ratings of Ireland and Portugal were downgraded to the 'triple-B' category whilst the rating of Greece was downgraded to sub-investment (or 'junk') grade. The sovereign rating of Spain was also downgraded but remained in the 'double-A' category.

During the year money market rates increased marginally at the shorter end (overnight to 3 months). 6 - 12 month rates increased between 0.25% to 0.30% over the 12 month period reflecting the expectation that the Bank Rate would be raised later in 2011.

3. The Borrowing Requirement and Debt Management

	Balance on 31/3/2010 £m	Debt Maturing £m	Debt Prematurely Repaid £m	New Borrowing £m	Transfer to Short Term £m	Balance on 31/3/2011 £m
CFR	162					150
Short Term Borrowing	5	(4)	(1)	0	5	5
Long Term Borrowing	132		(13)	0	(5)	114
TOTAL BORROWING	**137**	**(4)**	**(14)**	**0**	**0**	**119**
Other Long Term Liabilities	0	0	0	0	0	0
TOTAL EXTERNAL DEBT	**137**	**(4)**	**(14)**	**0**	**0**	**119**
Increase/ (Decrease) in Borrowing £m						18

The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31/3/2011 was estimated at £150m. The Council's net borrowing requirement during the year was £0m .

The Council funded all of its capital expenditure through internal borrowing. This has, for the time being, lowered overall treasury risk by reducing both external debt and temporary investments. Whilst this position is expected to continue in 2011/12, it will not be sustainable over the medium term and the Council expects it will need to borrow £7.5m for capital purposes by 2012/13.

4. Investment Activity

The Welsh Assembly Government's (WAG's) revised Investment Guidance came into effect on 1st April 2010 and reiterated the need to focus on security and liquidity, rather than yield. It also recommended that strategies include details of assessing credit risk, reasons for borrowing in advance of need and the use of treasury advisers.

Investments	Balance on 31/3/2010 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/03/2011 £m
Short Term Investments	55.5	305.8	323.2	38.1
Long Term Investments		25.0		25.0
Investments in Money Market Funds	4.0	5.0	4.0	5.0
TOTAL INVESTMENTS	**59.5**	**335.8**	**327.2**	**68.1**
Increase/ (Decrease) in Investments £m				8.6

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2010/11. Investments during the year included:

- Deposits with other Local Authorities;
- Investments in AAA-rated Money Market Funds;
- Call accounts and deposits with Banks and Building Societies systemically important to that country's banking system (UK, Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US).

Credit Risk: Counterparty credit quality was assessed and monitored with reference to credit ratings (Council's minimum long-term counterparty rating of A+ across all three rating agencies, Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price. Counterparty credit quality has progressively strengthened as demonstrated by the Credit Score Analysis summarised below. The table in Appendix 2 explains the credit score.

Date	Value Weighted Average Credit Risk Score	Value Weighted Average Credit Rating	Time Weighted Average Credit Risk Score	Time Weighted Average Credit Rating	Average Life (days)
31/03/2010	4.10	AA-	4.20	AA-	104
30/06/2010	4.08	AA-	4.24	AA-	43
30/09/2010	3.93	AA-	3.94	AA-	86
31/12/2010	3.88	AA-	4.15	AA-	169
31/03/2011	3.69	AA-	2.26	AA+	109

Liquidity: In keeping with the WAG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds, overnight deposits and the use of call accounts.

Yield: The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates remained at very low levels which had a significant impact on investment income.

Update on our Investments with the Heritable Bank
Following guidance from CIPFA, issued in September 2010, and further developments within the financial year, the following is now known.

It is now expected that 85p/£ will be recovered overall. Repayments in 2010/11 were 6.27% in July, 4.14% in October and 4.72% in January. In total, 50.11% was repaid by 31 March 2011.

5. Compliance with Prudential Indicators

Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003, requires the Council to set an authorised Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Council's Authorised Borrowing Limit was set at £160m for 2010/11. There were no breaches to the Authorised Limit during the period to 30/09/10.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2010/11 was set at £135m.

The operational boundary of £135m was breached between 1 April and 15 April 2010, when borrowing was £137.5m. This breach occurred as a result of the delay in the housing stock transfer. The strategy for 2010/11 was based on the assumption that the transfer would happen on 29 March 2010, and that £14.1m of the PWLB loans would have been repaid by 31 March 2010. Had this happened our borrowing on the 1 April would have been £123.4m and we would have been within the limit. Unfortunately as the transfer was delayed we were inevitably over our limit until the transfer happened and the £14.1m debt was repaid on the 15 April 2010. Subsequently we have operated within the operational boundary as set.

The Council can confirm that it has complied with all its other Prudential Indicators for 2010/11, which were set in Q1 2010 as part of the Council's Treasury Management Strategy Statement. Details can be found in Appendix 1.

<u>**Appendix 1**</u>

<u>Prudential Indicators 2010-11</u>

Capital Financing Requirement
Estimates of the Council's cumulative maximum external borrowing requirement for 2010/11 to 2012/13 are shown in the table below:

	31/3/2011 Estimate £000s	31/3/2011 Actual £000s	31/3/2012 Estimate £000s	31/3/2013 Estimate £000s
Capital Financing Requirement	149,865	150,473	164,738	167,869
Less: Existing Profile of Borrowing	(118,700)	(118,565)	(113,778)	(112,531)
Less: Other Long Term Liabilities	(200)	(137)	(49)	(20)
Cumulative Maximum External Borrowing Requirement	**30,965**	**31,771**	**50,911**	**55,318**

Balances and Reserves
Estimates of the Council's level of Balances and Reserves for 2010/11 to 2012/13 are as follows:

	31/3/2011 Estimate £000s	31/3/2011 Actual £000s	31/3/2012 Estimate £000s	31/3/2013 Estimate £000s
Balances and Reserves	51,900	70,394	52,164	47,804

<u>Prudential Indicator Compliance</u>

(a) Authorised Limit and Operational Boundary for External Debt

The Local Government Act 2003 requires the Council to set an Authorised Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached. The Council's Authorised Borrowing Limit was set at £160m for 2010/11. The Authorised Limit was not breached during 2010/11.

The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The Operational Boundary for 2010/11 was set at £135m. The Head of Finance confirms that there was a breach in the Operational Boundary between 1 and 15 April 2010. Details are provided in Para.5 on page 3 of this report.

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.
The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2010/11 £/%	Maximum during 2010/11 £/%
Upper Limit for Fixed Rate Exposure	100%	100%
Compliance with Limits:	Yes	Yes
Upper Limit for Variable Rate Exposure	50%	0%
Compliance with Limits:	Yes	Yes

(c) Maturity Structure of Fixed Rate Borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing as at 31/03/2011	% Fixed Rate Borrowing as at 31/03/2011	Compliance with Set Limits?
under 12 months	0%	25%	£4,786,940	4.03%	Yes
12 months and within 24 months	0%	25%	£17,455,613	14.71%	Yes
24 months and within 5 years	0%	50%	£2,110,448	1.78%	Yes
5 years and within 10 years	0%	75%	£7,377,108	6.22%	Yes
10 years and within 20 years	0%	100%	£20,556,962	17.33%	Yes
20 years and within 30 years	0%	100%	£36,803,852	31.02%	Yes
30 years and within 40 years	0%	100%	£2,209,115	1.86%	Yes
40 years and above	0%	100%	£27,352,375	23.05%	Yes
TOTAL			**£118,652,413**	**100.00%**	

(d) Total principal sums invested for periods longer than 364 days

This indicator allows the Council to manage the risk inherent in investments longer than 364 days.
The limit for 2010/11 was set at £40m.
The Council's policy response since the onset of the credit crunch in 2007 has been to keep investment maturities to a maximum of 1 year. No investments were made for a period greater than 1 year during this period.

Appendix 2

Credit Score Analysis

Scoring:

Long-Term Credit Rating	Score
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10
Not rated	11
BB	12
CCC	13
C	14
D	15

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investments according to the maturity of the deposit

The Council aims to achieve a score of 5 or lower, to reflect the Council's overriding priority of security of monies invested and the minimum credit rating of threshold of A+ for investment counterparties.