Part I – Release
to Press

Meeting: **Audit Committee /Executive** **Agenda Item:** **4**

Portfolio Area: Resources

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ANNUAL TREASURY MANAGEMENT REVIEW 2011/12

NON-KEY DECISION

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1. PURPOSE

1.1 The Council is required under the Local Government Act 2003 to produce an Annual Treasury Report reviewing treasury management activities including the 2011/12 prudential and treasury indicators. 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).

1.2. This report is one of three reports required under the code of practice, the other reports being :

- Annual Treasury Strategy in advance of the year (last reported 23/02/2011)
- Mid year Treasury Update report (last reported Council 7/12/2011)

2. RECOMMENDATIONS

2.1. That Council be recommended to approve the 2011/12 prudential and treasury indicators in this report.

3. BACKGROUND

3.1 Summary

3.1.1 It is a requirement of the Treasury Management Code of Practice (revised 2009) that Council receive an annual report on the performance of the treasury management function.

3.1.2 This report summarises:

- Capital expenditure for 2011/12;
- Impact of the expenditure 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.

4. REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

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

4.1.1 Capital expenditure is monies expended on assets with a life of more than one year, within the guidelines laid out in Accounting Practises. These costs can be financed either by capital resources the Council has on its Balance Sheet e.g. capital receipts, capital grants, revenue contributions etc. or by making a revenue contribution to capital.

4.1.2 If sufficient capital resources are not available this would give rise to a need to borrow. The actual capital expenditure for the year forms part of the required prudential indicators. Table One (shown below) summarises the actual capital expenditure and how this was financed.

4.1.3 In addition to the council's normal programme expenditure on the HRA and General Fund, the council was required to make a 'self financing' payment over to the Department for Communities and Local Government (DCLG) totalling £199,911,000. This was the calculated contribution due from this council as part of the abolition of the Housing Subsidy system from 2012/13.

Table One- 2011/12 Capital Expenditure and Financing

	2010/11 Actual £'000	2011/12 Estimate £'000	2011/12 Actual £'000
Non-HRA Capital Expenditure	6,069	5,568	4,661
HRA Capital Expenditure	17,300	13,505	13,281
Total Capital Expenditure	**23,369**	**19,073**	**17,942**
Resourced by:			
• Capital Receipts	2,464	57	415
• Capital Grants /Contributions	3,932	3,105	2,495
• Capital Reserves	6,020	7,005	6,939
• Revenue contributions	0	393	360
Capital Programme Expenditure Requiring Borrowing	**10,953**	**8,515**	**7,733**
HRA Self Financing Settlement	**0**	**199,911**	**199,911**
Total Expenditure Requiring borrowing	**10,953**	**208,426**	**207,644**

4.2 The Council's overall borrowing need

4.2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure calculates the Council's debt position. The CFR can be calculated by totalling the capital activity of the Council less the resources which have been used to pay for the capital spend. The CFR represents the 2011/12 and prior years unfinanced capital expenditure (see Table One), and prior years' unfinanced capital expenditure which requires funding via borrowing or the use of internal cash balances, rather than by the application of capital resources e.g. capital receipts.

4.2.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Based on the Capital Strategy, the treasury service manages the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

4.3 The 2011/12 Capital Financing Requirement and Minimum Revenue Requirement

4.3.1 In 2011/12 the Council did not borrow to fund the General Fund capital programme, this was despite an amount of £2,800,000 included in the Capital Strategy. This was due in part to slippage, but there remained an unfinanced spend of £1,803,028 for the General Fund, in addition to £5,929,310 on HRA decent homes.

4.3.2 Rather than externally borrowing the total funding requirement of £7,732,338, the council instead used cash balances (effectively reducing the value of investments held). This is because investment returns are extremely low reflecting the historic low rates of interest. The council was receiving interest at only 0.8% on its investments, compared to borrowing costs available of around 4%.

4.3.3 The Council has HRA external borrowing with the PWLB as at 31 March 2012 of £216,915,000.

4.3.4 The HRA borrowing included £17,004,000 to fund the prior years decent homes programme, this debt remained unchanged from 31 March 2011. This debt was called 'supported borrowing' under the former HRA Subsidy system. This now forms part of the HRA debt portfolio for self financing. The HRA has a debt cap of £217,685,000 as at 31 March 2012, £739,000 of the total HRA borrowing has not been taken externally, but funded from investments, for the reasons described in 4.3.2.

4.3.5 In 2011/12 the Council was required to finance the payment required to central government of £199,911,000. This was financed by borrowing fixed rate debt of varying maturities.

4.3.6 The Council must borrow in line with the Prudential Code which requires the Council to demonstrate a need to borrow and to show the cost of that borrowing on either the General Fund or HRA, (see Appendix A Prudential Indicators). Statutory controls are in place to ensure that borrowing for capital assets is repaid over the life of the asset. This is done through the Minimum Revenue Requirement (MRP), which effectively equates to repaying the principal or monies borrowed, in line with how long the asset will last. The Council is required to make an annual revenue charge, or MRP, which reduces the CFR and so the underlying need to borrow. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments.

4.3.7 The statutory requirement to repay debt does not necessarily have to coincide with the physical borrowing. When borrowing interest rates are relatively high compared to investment interest earned, the Council may decide to use investment balances to finance expenditure, until rates converge and borrow at a later date.

4.3.8 The Council could reduce its CFR further by:

- the application of additional capital financing resources (such as unapplied capital receipts); or

- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

4.3.9 The Council's 2011/12 MRP Policy, as required by CLG Guidance, was approved as part of the 2011/12 Treasury Management Strategy Report on 23 February 2011. However because of the slippage on the 2011/12 capital programme, the Council did not require all of its approved £2,800,000 of borrowing requirement in 2011/12, and only had an underlying need to borrow £1,803,028. As the calculation of MRP is based upon the opening borrowing requirement provision has been made for £105,050 in 2012/13.

4.3.10 The Council's CFR for the year is shown below, and represents a key prudential indicator.

Table Two CFR calculation 2010/11 and 2011/12		
CFR Calculation	**31 March 2011 (£'000)**	**31 March 2012 (£'000)**
Opening Balance	**6,051**	**17,004**
Closing Capital Financing Requirement (General Fund)	26,743	6,992
Closing Capital Financing Requirement (Housing Revenue Account)	(9,739)	217,655
Closing Balance	**17,004**	**224,647**

4.3.11 The CFR as at 31 March 2012 has increased by £207,643,336. The HRA movement relates to £199,911,000 self financing payment to government and £5,929,308 expenditure on Decent Homes, and the General Fund movement relates to £1,803,028 requiring funding through prudential borrowing, however the council has chosen not to use external borrowing in 2011/12, but to use investment balances.

4.4 Other indicators

4.4.1 The **net borrowing position** of the Council as at 31 March 2012 was £205,355,000 borrowing. This was total borrowings or loans of £216,915,000 less total investments held of £11,560,000. The council has lower investment balances than originally planned, as it is more financially beneficial to use investment balances to finance the capital programme, than to undertake the approved borrowing at this time.

4.4.2 The **authorised limit and operational boundary** is the limit at which the Council can borrow up to, a breach of the authorised limit would require a report to Council. The limits for 2011/12 included an additional £5Million for the authorised limit, above the anticipated long term borrowing needs of the Council. This was to allow for any short term cash flow needs that might arise during the course of the year or the ability to borrow (up to the limit) to cover any additional capital needs that might arise and be approved as part of the Capital Strategy.

4.4.3 These indicators for 2011/12 were reviewed and updated as part of the 2012/13 Treasury Management Strategy to include the effects of the introduction of Self Financing for the HRA in 2012/13. This adjustment was required because the transaction took place on 28 March 2012.

4.4.4 The **ratio of financing costs to net revenue stream,** this is the interest costs divided by the General Fund net requirement. The 2011/12 indicator is lower than estimated, this is because the council reduced its investment balances to meet its borrowing requirement, rather than undertake external borrowing. This is because the councils borrowing requirement was also lower than anticipated, as a result of slippage on the capital programme.

4.4.5 An updated list of all Treasury Prudential Indicators is shown at Appendix A and include an update on the 2011/12 indicators as a result of the 2011/12 actuals. All Prudential Indicators will be further reviewed and updated at a later date, taking into account approved changes to the capital programme, and borrowing and debt projections.

4.5 Treasury Position 31 March 2012

4.5.1 The Council's debt and investment position is organised by the Treasury Management section, in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risk.

4.6 Borrowing and Investment Position

4.6.1 At the beginning and end of 2011/12 the Council's treasury position was thus:

Table Three Treasury Position as at 31 March 2012

	31 March 2011 Principal £'000s	Rate / Return %	Average Life (Yrs)	31 March 2012 Principal £'000s	Rate / Return %	Average Life (Yrs)
Fixed rate funding - PWLB*	17,004	3.99	14.10	216,915	3.77	20.93
CFR	17,004			224,647		
Over/(under) borrowing	0	0		(7,732)	(3.4)	
Investments – In house	15,990	0.93		11,560	0.85	

**All borrowings taken out were fixed rate.*

4.6.2 The maturity structure of debt portfolio was as follows:

Table Four Maturity of Debt Portfolio for 2009/10 and 2011/12		
Time to maturity	**31 March 2011 Actual**	**31 March 2012 Actual**
Maturing within one year	0	3,000
1 year or more and less than 2 years	0	2,000
2 years or more and less than 5 years	5,500	5,500
5 years or more and less than 10 years	3,741	3,741
10 years or more	7,763	202,674
Total	**17,004**	**216,915**

4.6.3 All the Council's investments at both 31 March 2011 and 2012, were due or mature within one year. A summary of the Council's exposure to fixed and variable rate principal is shown below in table was thus:

Table Five Fixed and Variable Rate Investment Totals for 2009/10 and 2011/12		
	31 March 2011 Actual	**31 March 2012 Actual**
Fixed rate principal	3,000	0
Variable rate principal	12,990	11,560

4.7 The Strategy for 2011/12:

4.7.1 The outturn against the original 2011/12 Strategy remained largely in line with expectations. Although the original Strategy was amended to reflect a change in profile (delay) in receiving capital receipts, there was also slippage against the capital programme. The most significant amendments made to the strategy in year relate to the take on of housing debt for self financing. The values were not known at the time that the original strategy was approved.

4.7.2 A review of counterparty limits left them unchanged at £5Million. The lower limit is still considered necessary due to continued uncertainty in the banking sector. The council are investigating the use of different counterparties, including the use of Money Market Funds and building societies, ensuring that the risk levels are low and commensurate with our security policy.

4.8 Compliance with Prudential Limits 2011/12

4.8.1 There were no breaches of prudential indicators during the year.

4.8.3 The full list of approved Treasury Prudential Indicators and their corresponding actual expenditure for 2011/12 are shown at Appendix A.

4.9 2011/12 Economic & Interest Rate Review

4.9.1 The original expectation for 2011/12 was that Bank Rate would start gently rising from December 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.

4.9.2 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.

4.9.3 **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.

4.9.4 **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.

5. **IMPLICATIONS**

5.1 Financial Implications

5.1.1 This report is of a financial nature and reviews the treasury management function for the 2011/12 financial year any consequential financial impacts of the Strategy have been reflected in the July Capital Strategy update and the 4th Quarter 2011/12 budget monitoring report.

5.2 Legal Implications

5.1.2 Approval of the Prudential Code Indicators and the Treasury Management are intended to ensure that the Council complies with relevant legislation and best practice.

5.3 Risk Implications

5.1.3 The table below identifies the risks if the recommendations are agreed. The risks have been assessed in accordance with the Council's risk management strategy.

	Description of risk	Mitigation	Residual Risk Level
1.	Investment balances increase and monies placed with banking groups exceed approved Counter Party Limits	The Treasury Team would actively seek to find alternative Counter Parties to lend to, or seek Council approval to increase the Counter Party Limits	M
2.	There is a reduction in available resources to fund the capital programme.	If the CFR increased in 2011/12 because the Council needed to borrow additional funds this would have to be in excess of the current headroom of £10Million in the operational boundary limit	L
3	The Council invests funds with a bank which is unable to meet the repayment.	The Counter Party ratings are reviewed on a weekly basis and should prevent placing funds with banks at risk. The Council has a very strict lending criteria.	L

5.4 Equalities and Diversity Implications

5.4.1 All the services identified in the report have their own Equalities Impact Assessments, which are reviewed where appropriate.

6 BACKGROUND DOCUMENTS

- Treasury Management Reports
- Sector Reports

7 APPENDICES

- Appendix A – Prudential Indicators