AGENDA ITEM NO: 5

HAMBLETON DISTRICT COUNCIL

Report To: Cabinet
19 July 2011

Subject: **ANNUAL TREASURY MANAGEMENT REPORT 2010/11**

All Wards
Audit & Governance Committee
Cabinet Member for Corporate Management: Councillor R Kirk

1.0 PURPOSE AND BACKGROUND:

1.1 The purpose of this report is to present a summary of the treasury management activities for the last financial year (2010/11) in line with the Treasury Management Code of Practice.

1.2 The Annual Treasury Management Report for 2010/11 is attached as Annex A. It is presented as part of the Code's requirement to present regular reports to Members on Treasury Management. The report sets out the Treasury Management position for 2010/11 and how the Council has performed in this area.

2.0 DECISION SOUGHT:

2.1 Members are asked to consider the contents of the Annual Treasury Management Report for 2010/11.

3.0 RISK ANALYSIS:

3.1 There are no major risks associated with the recommendations of this report. The Council's Constitution (under the Treasury Management section of the Financial Procedure Rules) requires that Cabinet receive an annual report on treasury management activities. If a report was not forthcoming to Cabinet, it would clearly breach the Constitution, and Members would not be kept informed of activities in this important aspect of the Council's finances. In addition, I would expect the Council's external auditors, Deloitte, to comment on the omission as part of their annual Audit and Inspection work.

4.0 FINANCIAL IMPLICATIONS AND EFFICIENCIES:

4.1 There are no financial implications in approving this report although Members may wish to note that income from investments exceeded the budget by nearly £22,000 (see paragraph 12 of Annex A).

5.0 RECOMMENDATION:

5.1 It is recommended to Council that, subject to any comments from the Audit and Governance Committee, the Annual Treasury Management Report for 2010/11 is approved.

DAVE SIMPSON
Background papers: None
Author ref: DS
Contact: Dave Simpson
Head of Finance
Direct Line No: 767024

Annex A

ANNUAL TREASURY MANAGEMENT REPORT FOR 2010/11

1.0 PURPOSE:

1.1 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 2010/11. 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 During 2010/11 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Strategy Board 30/03/10)
- a mid year (minimum) treasury update report (Strategy Board30/11/10)
- an annual report following the year describing the activity compared to the strategy (this report)

1.3 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.

1.4 This Council also confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit and Governance Committee before they were reported to the full Council.

2.0 EXECUTIVE SUMMARY:

2.1 During 2010/11, 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:

Prudential and Treasury Indicators	2009/10 Actual £000	2010/11 Original £000	2010/11 Actual £000
Actual Capital Expenditure	4,432	1,884	1,562
Total Capital Financing Requirement:			
• Non-HRA	-	-	-
• HRA	-	-	-
• Total	-	-	-
Net Borrowing	-	-	-
External Debt	-	-	-
Investments:			
• Longer than 1 year	-	-	-
• Under 1 year	19,200	19,200	18,600
• Total	19,200	19,200	18,600

2.2 Other prudential and treasury indicators are to be found in the main body of this report. The Head of Finance & S151 Officer also confirms that no external borrowing for capital purposes was undertaken and the statutory borrowing limit (the authorised limit), was not breached.

2.3 The financial year 2010/11 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

3.0 INTRODUCTION AND BACKGROUND:

3.1 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;
- Detailed investment activity;

4.0 THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2010/11:

4.1 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.

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

	2009/10 Actual £000	2010/11 Original £000	2010/11 Actual £000
Non-HRA capital expenditure	4,432	1,884	1,562
HRA capital expenditure	-	-	-
Total capital expenditure	4,432	1,884	1,562
Resourced by:			
• Capital Receipts	1,463	1,010	749
• Capital Grants	2,945	774	797
• Capital Reserves	-	-	14
• Revenue	24	-	2
Unfinanced capital expenditure	-	-	-

5.0 THE COUNCIL'S OVERALL BORROWING NEED:

5.1 A Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of a Council's debt position. The CFR results from the capital activity of a Council and what resources have been used to pay for the capital spend. The CFR represents the 2010/11 unfinanced capital expenditure and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources (see above table).

5.2 As a debt free authority the Council does not have a CFR.

5.3 **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 2010/11 the Council has maintained gross borrowing within its authorised limit.

5.4 **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.

5.5 **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.

	2010/11
Authorised limit	£5.0 m
Maximum gross borrowing position	£0.0 m
Operational boundary	£4.0 m
Average gross borrowing position	£0.0 m
Financing costs as a proportion of net revenue stream	0.0 %

6.0 TREASURY POSITION AS AT 31 MARCH 2011:

6.1 The Council's debt and investment position is organised by the treasury management service in order 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 2010/11 the Council's treasury position was as follows:

	1 April 2010	**Rate %**	**31 March 2011**	**Rate %**
Fixed Rate Funding:				
- PWLB	-	0.0%	-	0.0%
- Market	-		-	
	-		-	
Variable Rate Funding:				
- PWLB	-		-	
- Market	-		-	
	-		-	
Total Debt	**-**	**0.0%**	**-**	**0.0%**
CFR	**-**		**-**	
Over/(Under) Borrowing	**-**		**-**	
Investments				
- In-house	19,200		18,600	
- Fund Managers	-		-	
Total Investments	**19,200**		**18,600**	

6.2 The maturity structure of the debt portfolio was as follows:

	31 March 2010 Actual	**2010/11 Original Limits**	**31 March 2011 Actual**
Under 12 months	£0.00 m	£0.00 m	£0.00 m
12 months and within 24 months	£0.00 m	£0.00 m	£0.00 m
24 months and within 5 years	£0.00 m	£0.00 m	£0.00 m
5 years and within 10 years	£0.00 m	£0.00 m	£0.00 m
10 years and above	£0.00 m	£0.00 m	£0.00 m

6.3 The maturity structure of the investment portfolio was as follows:

	2009/10 Actual £000's	**2010/11 Original £000's**	**2010/11 Actual £000's**
Investments:			
- Longer than 1 year	-	-	-
- Under 1 year	19,200	19,200	18,600
Total Investments	19,200	19,200	18,600

6.4 The exposure to fixed and variable rate investments was as follows:

	31 March 2010 Actual	**2010/11 Original Limits**	**31 March 2011 Actual**
Fixed Rate	19,200	19,200	18,600
Variable Rate	-	-	-

7.0 THE STRATEGY FOR 2010/11:

7.1 The strategy for 2010/11 did not anticipate any need to borrow during the year although the option was kept open should there be a need to borrow identified.

7.4 **Change in strategy during the year** – the strategy adopted in the original Treasury Management Strategy Report for 2010/11 approved by the Council on 13 April 2010 was not changed through the financial year 2010/11.

8.0 THE ECONOMY AND INTEREST RATES:

8.1 2010/11 proved to be another watershed year for financial markets. Rather than a focus on individual institutions, market fears moved to sovereign debt issues, particularly in the peripheral Euro zone countries. Local authorities were also presented with changed circumstances following the unexpected change of policy on Public Works Loan Board (PWLB) lending arrangements in October 2010. This resulted in an increase in new borrowing rates of 0.75 – 0.85%, without an associated increase in early redemption rates. This made new borrowing more expensive and repayment relatively less attractive.

8.2 UK growth proved mixed over the year. The first half of the year saw the economy outperform expectations, although the economy slipped into negative territory in the final quarter of 2010 due to inclement weather conditions. The year finished with prospects for the UK economy being decidedly downbeat over the short to medium term while the Japanese disasters in March, and the Arab Spring, especially the crisis in Libya, caused an increase in world oil prices, which all combined to dampen international economic growth prospects.

8.3 The change in the UK political background was a major factor behind weaker domestic growth expectations. The new coalition Government struck an aggressive fiscal policy stance, evidenced through heavy spending cuts announced in the October Comprehensive Spending Review, and the lack of any "giveaway" in the March 2011 Budget. Although the main aim was to reduce the national debt burden to a sustainable level, the measures are also expected to act as a significant drag on growth.

8.4 Gilt yields fell for much of the first half of the year as financial markets drew considerable reassurance from the Government's debt reduction plans, especially in the light of Euro zone sovereign debt concerns. Expectations of further quantitative easing also helped to push yields to historic lows. However, this positive performance was mostly reversed in the closing months of 2010 as sentiment changed due to sharply rising inflation pressures. These were also expected (during February / March 2011) to cause the Monetary Policy Committee to start raising Bank Rate earlier than previously expected.

8.5 The developing Euro zone peripheral sovereign debt crisis caused considerable concerns in financial markets. First Greece (May), then Ireland (December), were forced to accept assistance from a combined EU / IMF rescue package. Subsequently, fears steadily grew about Portugal, although it managed to put off accepting assistance till after the year end. These worries caused international investors to seek safe havens in investing in non-Euro zone government bonds.

8.6 Deposit rates picked up modestly in the second half of the year as rising inflationary concerns, and strong first half growth, fed through to prospects of an earlier start to increases in Bank Rate. However, in March 2011, slowing actual growth, together with weak growth prospects, saw consensus expectations of the first UK rate rise move back from May to August 2011 despite high inflation. However, the disparity of expectations on domestic economic growth and inflation encouraged a wide range of views on the timing of the start of increases in Bank Rate in a band from May 2011 through to early 2013. This sharp disparity was also seen in MPC voting which, by year-end, had three members voting for a rise while others preferred to continue maintaining rates at ultra low levels.

8.6 Risk premiums were also a constant factor in raising money market deposit rates beyond 3 months. Although market sentiment has improved, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, mean that investors remain cautious of longer-term commitment. The European Commission did try to address market concerns through a stress test of major financial institutions in July 2010. Although only a small minority of banks "failed" the test, investors were highly sceptical as to the robustness of the tests, as they also are over further tests now taking place with results due in mid-2011.

Chart 1: Bank Rate v LIBID investment rates

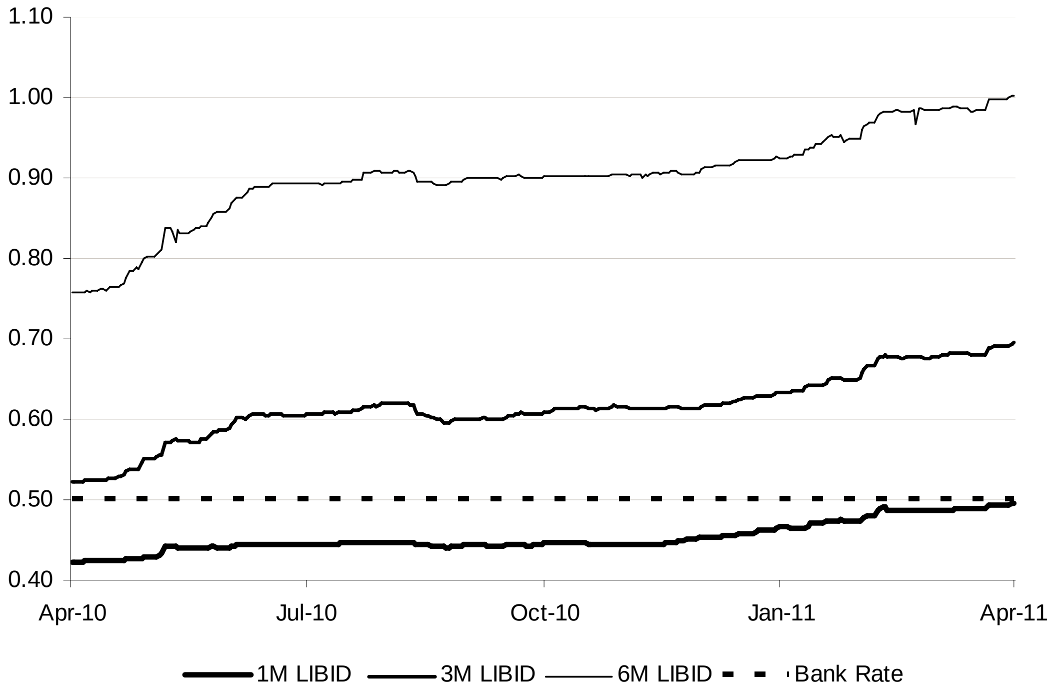
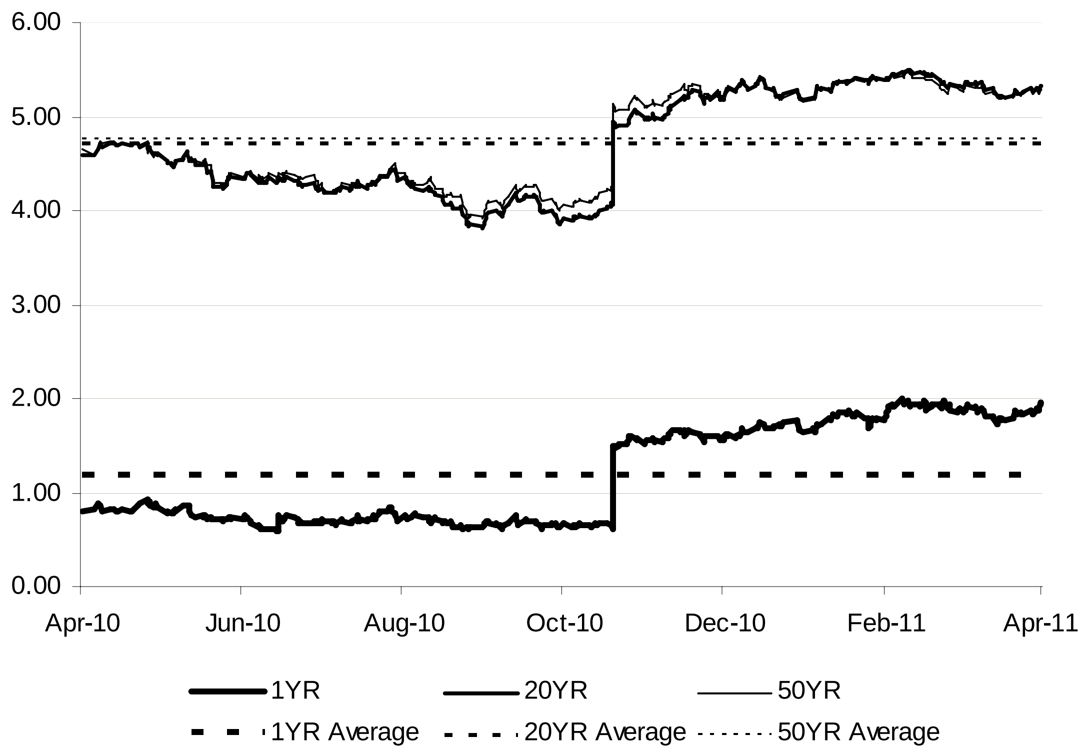


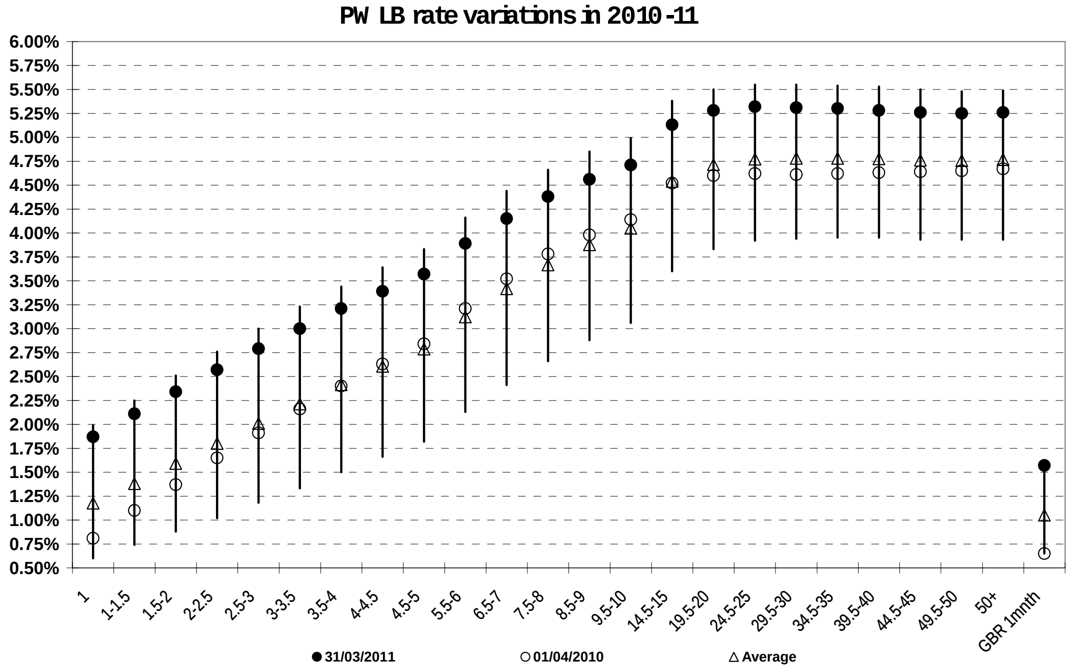
Chart 2: Average v new borrowing rates



9.0 <u>BORROWING RATES IN 2010/11:</u>

9.1 **PWLB borrowing rates -** the graph and table for PWLB maturity rates below show, for a selection of maturity periods, the range (high and low points) in rates, the average rates and individual rates at the start and the end of the financial year.

9.2 Variations in most PWLB rates have been distorted by the October 2010 decision by the PWLB to raise it borrowing rates by about 0.75 – 0.85% e.g. if it had not been for this change, the 25 year PWLB at 31 March 2011 (5.32%) would have been only marginally higher than the position at 1 April 2010.



PWLB BORROWING RATES 2010/11 for 1 to 50 YEARS

Years	1	1.5 - 2	2.5 - 3	3.5 - 4	4.5 - 5	9.5 - 10	24.5 - 25	49.5 - 50	1 Month Variable
01/04/10	0.810%	1.370%	1.910%	2.400%	2.840%	4.140%	4.620%	4.650%	0.650%
31/03/11	1.870%	2.340%	2.790%	3.210%	3.570%	4.710%	5.320%	5.250%	1.570%
High	1.990%	2.510%	3.000%	3.440%	3.830%	4.990%	5.550%	5.480%	1.570%
Low	0.600%	0.880%	1.180%	1.500%	1.820%	3.060%	3.920%	3.930%	0.650%
Average	1.177%	1.590%	2.009%	2.413%	2.788%	4.050%	4.771%	4.756%	1.052%
Spread	1.390%	1.630%	1.820%	1.940%	2.010%	1.930%	1.630%	1.550%	0.920%
High Date	07/02/11	07/02/11	07/02/11	07/02/11	09/02/11	09/02/11	09/02/11	09/02/11	07/03/11
Low Date	15/06/10	12/10/10	12/10/10	12/10/10	12/10/10	31/08/10	31/08/10	31/08/10	01/04/10

10.0 <u>THE BORROWING OUTTURN FOR 2010/11:</u>

10.1 **Treasury Borrowing** – the Council undertook no external borrowing for cash flow purposes during 2010/11.

10.2 **Borrowing** – the Council undertook no external borrowing for financing purposes during 2010/11. The capital programme was financed by a mixture of external grants, capital receipts, reserve funding and revenue contributions.

10.3 **Rescheduling** – the Council undertook no rescheduling of debt during 2010/11.

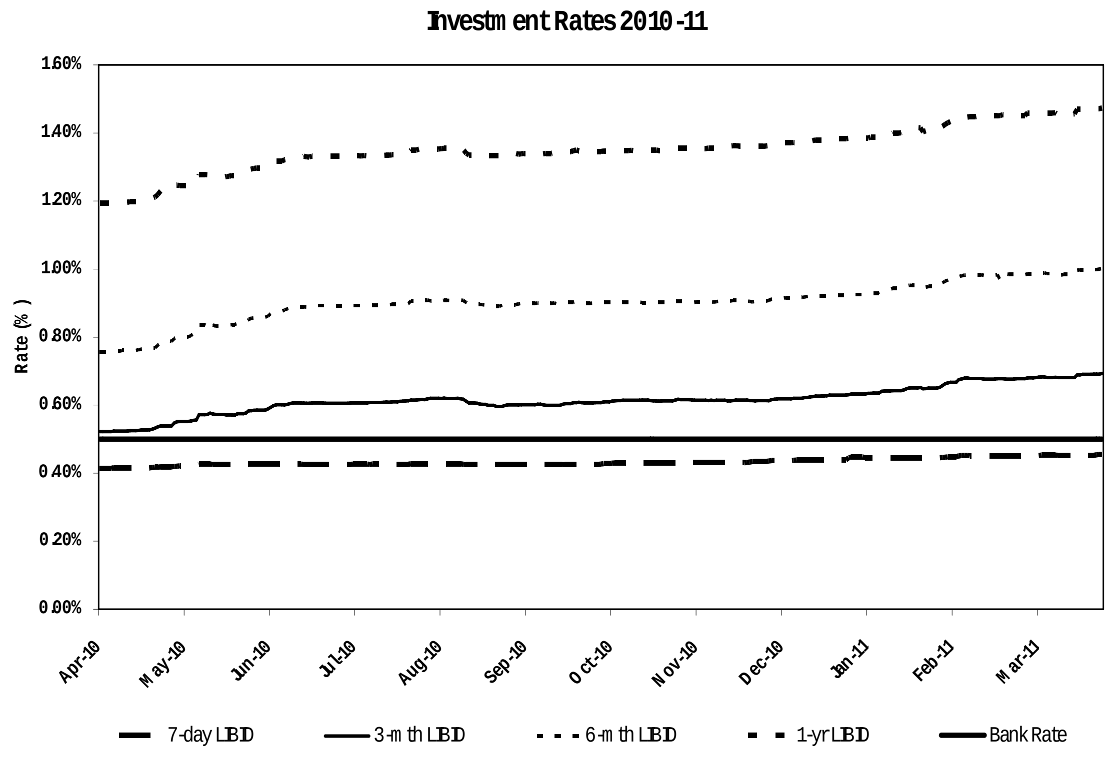
10.4 **Repayment** – the Council has no external loans and therefore no repayments were necessary.

11.0 INVESTMENT RATES IN 2010/11:

11.1 The tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in the shorter term deposit rates. Bank Rate remained at its historical low of 0.5% throughout the year, although growing market expectations of the imminence of the start of monetary tightening saw 6 and 12 month rates picking up.

11.2 Overlaying the relatively poor investment returns was the continued counterparty concerns, most evident in the Euro zone sovereign debt crisis which resulted in rescue packages for Greece, Ireland and latterly Portugal. Concerns extended to the European banking industry with an initial stress testing of banks failing to calm counterparty fears, resulting in a second round of testing currently in train. This highlighted the ongoing need for caution in treasury investment activity

	Overnight	7 Day	1 Month	3 Month	6 Month	1 Year
01/04/10	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
31/03/11	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
High	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
Low	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
Average	0.43%	0.43%	0.45%	0.61%	0.90%	1.35%
Spread	0.03%	0.04%	0.07%	0.17%	0.24%	0.28%
High Date	31/12/10	30/03/11	31/03/11	31/03/11	31/03/11	31/03/11
Low Date	01/04/10	01/04/10	01/04/10	01/04/10	01/04/10	01/04/10



12.0 INVESTMENT OUTTURN FOR 2010/11:

12.1 **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 13 April 2010. 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 data (such as rating outlooks, credit default swaps, bank share prices etc.).

12.2 One change to the Treasury Management Strategy for 2010/11 was made during the year. This related to raising the Group limit for investments from 1.0 to 1.5 times the individual limit. This was approved by Cabinet at its meeting of 22 June 2010 and full Council on 27 July.

12.2 The investment activity during the year conformed to the approved (amended) strategy, and the Council had no liquidity difficulties.

12.3 **Investments held by the Council** - the Council maintained an average balance of £25,600,000 of core cash investments. These internally managed funds earned an average rate of return of 1.41%., yielding £361,133 of interest. The comparable performance indicator is the average 7-day LIBID rate, which was 0.433%. This compares with a budget assumption of £23,000,000 investment balances earning an average rate of 1.48% and a budget of £340,000 for interest.

12.4 In addition, the Council manages cash flow money. During the year the Council maintained an average balance of £4,065,000 of cash flow investments. These internally managed funds earned an average rate of return of 0.56%., yielding £22,731 of interest. The comparable performance indicator is the average 7-day LIBID rate, which was 0.433%. This compares with a budget assumption of £2,930,000 investment balances earning an average rate of 0.75% and a budget of £22,000 for interest.

13.0 ICELANDIC BANK DEFAULTS AND OTHER ISSUES:

13.1 To complete the review of fund management activities for 2010/11 it is worth reminding ourselves of two connected issues.

13.2 Firstly, the Council did not hold any investments in the Icelandic banks which collapsed in October 2008, and no institutions in which investments were made during 2010/11 had any difficulty in repaying investments and interest in full during the year.

13.3 Secondly, the collapse of the Icelandic banks was the beginning of an unparalleled banking crisis that spread across the world and affected the banking sector and other market institutions as well as the world economies in general. It resulted in uncertainties in the market place that are still being felt today making budgetary and performance targets in this area difficult to predict with any level of certainty.

Annex A

PRUDENTIAL INDICATORS – OUTTURN 2010/11

PRUDENTIAL INDICATORS	2009/10	2010/11	2010/11
Extract from budget and rent setting report	**actual**	**original**	**actual**
	£'000	**£'000**	**£'000**
Capital Expenditure			
Non - HRA	£4,432	£1,884	£1,562
HRA (applies only to housing authorities)	-	-	-
TOTAL	£4,432	£1,884	£1,562
Ratio of financing costs to net revenue stream			
Non - HRA	N/A	N/A	N/A
HRA (applies only to housing authorities)	-	-	-
Net borrowing requirement			
brought forward 1 April	Nil	Nil	Nil
carried forward 31 March	Nil	Nil	Nil
in year borrowing requirement	Nil	Nil	Nil
Capital Financing Requirement as at 31 March			
Non – HRA	Nil	Nil	Nil
HRA (applies only to housing authorities)	-	-	-
TOTAL	Nil	Nil	Nil
Annual change in Cap. Financing Requirement			
Non – HRA	Nil	Nil	Nil
HRA (applies only to housing authorities)	-	-	-
TOTAL	Nil	Nil	Nil
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	£8.83	4.58	4.21
Increase in average housing rent per week (housing authorities only)	-	-	-

TREASURY MANAGEMENT INDICATORS	2009/10	2010/11	2010/11
	actual	original	actual
	£'000	£'000	£'000
Authorised Limit for external debt -			
borrowing	£5,000	£5,000	£5,000
other long term liabilities	-	-	-
TOTAL	£5,000	£5,000	£5,000
Operational Boundary for external debt -			
borrowing	£4,000	£4,000	£4,000
other long term liabilities	-	-	-
TOTAL	£4,000	£4,000	£4,000
Actual External Debt	Nil	Nil	Nil
Upper limit for fixed interest rate exposure expressed as:- Net principal re fixed rate borrowing / investments:-	£5,000	£5,000	£5,000
Upper limit for variable rate exposure expressed as:- Net principal re variable rate borrowing / investments	Nil	Nil	Nil
Upper limit for total principal sums invested for over 364 days (per maturity date)	£10,000	£12,500	£12,500

Maturity structure of fixed rate borrowing during 2010/11	upper limit	lower limit
under 12 months	100%	100%
12 months and within 24 months	0%	0%
24 months and within 5 years	0%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%