AGENDA ITEM NO. 8(1)

POLICY AND RESOURCES SCRUTINY COMMITTEE - 19TH JULY 2011

SUBJECT: TREASURY MANAGEMENT & CAPITAL FINANCING PRUDENTIAL INDICATORS OUTTURN REPORT FOR 2010/11

REPORT BY: DEPUTY CHIEF EXECUTIVE

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1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for 2010/11.

2. SUMMARY

2.1 The revised Code of Practice on Treasury Management in the Public Services, which was adopted by the Council on 12th October 2010, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). The Council subsequently approved the detailed TMPs on 23rd November 2010. TMP6 (Reporting Requirements and Management Information Arrangements) provides for the submission of monitoring reports to the appropriate committee on a quarterly basis.

2.2 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting)(Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's " The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

2.3 The Authority's Annual Investment Strategy and Capital Financing Prudential Indicators for 2010/11 were approved by Council on 25th February 2010.

3. LINKS TO STRATEGY

3.1 The report has links to the four basic strategic themes of the Council, taking into account cross-cutting issues where relevant. It has specific links to the effective and efficient application and use of resources.

4. THE REPORT

4.1 Treasury Management

4.1.1 <u>Background – Interest Rates</u>

The Monetary Policy Committee (MPC) decided to decrease Bank Rate in March 2009 to 0.50% as part of the Governments strategy to stimulate the economy. Sector, along with other analysts, forecast that bank rate would increase to 1.50% by the end of the year, but, as the recovery from the recession was not as strong as predicted, this forecast was ultimately incorrect and bank rate remained at 0.50% throughout the year.

4.1.2 Treasury Management Advice

Members are reminded that following the tender presentations in March 2010, two consultants were appointed to provide treasury management advice for the next two years.

Members are advised that the third consultant which tendered, Butlers, have subsequently been taken over by Sector, thereby reducing future competition for the next tender in 2012.

4.1.3 Borrowing

The Annual Strategy for 2010/11 set out that:-

- rescheduling opportunities should continue to be evaluated
- due to the level of interest rates, in particular the difference between long-term borrowing rates and short-term investment rates no new borrowing should be undertaken in 2010/11
- Internal borrowing would reduce funds available for investment, which would, in turn, reduce risk to the Authority

4.1.4 New Borrowing

The final borrowing requirement for 2010/11 of £10.252m was made up as follows:-

- replacement of maturing PWLB loans £3.260m.
- funding of 2010/11 capital programme £6.992m.

As indicated in the previous paragraph, the difference between long-term borrowing rates and short-term investment rates resulted in the fact that it was more advantageous to use internal funding for the capital programme in lieu of borrowing, this strategy also reduced risk in respect of the size of the investment portfolio. Consequently, no new borrowing was undertaken in 2010/11.

4.1.5 Rescheduling

The Council has engaged both Sector Treasury Services and Arlingclose to provide specialist advice with regard to Treasury Management activities. One of the areas where the expertise of external Treasury Consultants is of particular benefit is the identification of rescheduling opportunities – the premature repayment/replacement of existing loans to achieve revenue savings and/or the reduction of the Council's average rate of borrowing.

In 2010/11, there were no occasions when opportunities arose to reschedule PWLB loans.

4.1.6 Investments

The Annual Strategy for 2010/11 set out that:-

- the in-house team would manage all short-term investments in accordance with the Treasury Policy
- short-term investments should achieve, or better, a target rate of **0.50%**

In view of the uncertainty in the markets, it was recommended that investments (both new and maturing) be placed only with the Debt Management Account Deposit Facility (the U.K. government) and other local authorities. Lending to other local authorities was suspended from November 2010 due to the potential budget pressures some authorities were likely to experience as a result of the governments Comprehensive Spending Review. It was decided, however, to reinstate the use of the Bank of Scotland call account at the end of the year to provide flexibility in the new year should the Council move into Treasury Bills.

4.1.7 Short-term Investments – up to 364 Days

Throughout the year the in-house team managed investments averaging £71.496m. The return on these investments, which ranged from short-fixed to a maximum of three months, was 0.27% compared with the target of 0.50%. The poor return was due to the fact that deposits were made only with the institutions mentioned in 4.1.6 – the rates of interest received from the DMADF averaging 0.25% over the year. The amount of interest earned on these investments (excluding interest due but not received from Icelandic banks) was some £225k compared with the original estimate of £282K. The interest earned, considering the reduction in the rate of interest achieved, is due to the timing of payments resulting in higher balances being available throughout the year.

4.1.8 Long-term Investments

The Council currently has no long-term investments due to the continued uncertainty in the financial markets.

4.1.9 Icelandic Banks

The authority had deposits in Heritable and Landsbanki totalling £15m at the time of the collapse of the Icelandic Banks. These sums are subject to the ongoing administration and recovery procedures. Based on the information available in September 2009, the authority considered that an impairment should be recognised in the 2008/09 accounts.

In 2010/11, amounts were received from the administrators of Heritable to the value of £1.528m representing 15.129% of the amount outstanding, including accrued interest as at the 6/10/2008. A further sum of £631k was received in April 2011, bringing the total received to date to £5.691m.

Members are reminded that the Winding-up Board of Landsbanki made a decision to afford priority status to local authority deposits. This, however, was subject to legal challenge as expected. The Icelandic District Court subsequently ruled in favour of UK wholesale depositors, confirming priority status. However, this decision is subject to appeal to the Icelandic Supreme Court. It is unlikely that the case will come before the Court before September (2011).

4.1.10 A table summarising the full Treasury Management portfolio of loans and investments (excluding sums outstanding relating to Icelandic deposits) is shown in ***Appendix 1.***

4.2 Prudential Indicators

4.2.1 Capital Financing Requirement

The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice, and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in ***Appendix 2*** are set at a level in excess of the capital financing requirement.

During the year, the authority operated within the approved limits.

Appendix 3 shows the value of the Capital Financing Requirement as at 31 March 2011, based on the unaudited Balance Sheet position, is calculated to be £292.132m.

4.2.2 Prudential Indicators – “Prudence”

The Prudential Indicators for Treasury Management have, in the main, remained unchanged from those detailed in the Annual Strategy 2010/11 report presented to Council in February 2010, although, both the Authorised and Operational Boundary limits for External Debt have been reduced to reflect the reduction in PWLB debt due to premature repayments in previous years. Prudential indicators are shown in ***Appendix 2***. The authority is currently operating within approved limits.

4.2.3 Prudential Indicators – “Affordability”

There is a requirement to analyse and report the capital financing costs, and express those costs as a percentage of the net revenue streams of the authority. These are identified in ***Appendix 3*** attached.

Financing Costs to Net Revenue Stream.
General Fund - the unaudited out-turn, shows a decrease on the budgeted position. This is mainly attributable to reduced interest costs.

HRA
The ratio is marginally lower mainly as a result reduced interest charges relating to the apportionment between General Fund and the HRA.

Incremental effect of capital investment
Both General Fund and HRA, show a marginal increase in this measure as a result of the method of funding the capital programme.

4.2.4 Capital Expenditure and Funding

Capital Expenditure is reported in ***Appendix 4***, for information purposes. The table indicates the unaudited position as at 31 March 2011 compared to the previously reported forecast. More detail will be reported in due course.

5. FINANCIAL IMPLICATIONS

5.1 This report deals with financial matters.

6. PERSONNEL IMPLICATIONS

6.1 There are no personnel implications.

7. RECOMMENDATIONS

7.1 Members are asked to note the report.

8. REASONS FOR THE RECOMMENDATIONS

8.1 Compliance with the CIPFA “Code of Practice for Treasury Management in the Public Services”.

9. STATUTORY POWER

9.1 Not applicable.

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Background Papers:
Treasury Management Working Papers – Accountancy Section
CIPFA "Code of Practice for Treasury Management in the Public Services"
The Local Government Act 2003
Local Authorities (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2004

Appendices:

Appendix 1	Treasury Management Portfolio
Appendix 2	Prudential indicators
Appendix 3	Value of the Capital Financing Requirement
Appendix 4	Capital Expenditure