AGENDA ITEM NO. 6(2)

POLICY AND RESOURCES SCRUTINY COMMITTEE – 4TH OCTOBER 2011

SUBJECT: TREASURY MANAGEMENT AND CAPITAL FINANCING PRUDENTIAL INDICATORS MONITORING REPORT – 1ST QUARTER 2011/2012

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 the period 1st April to 31st July 2011.

1.2 To review the Treasury Management Strategy for 2011/2012 as set out in the Annual Investment Strategy and Capital Financing Prudential Indicators Report.

2. SUMMARY

2.1 The new Code of Practice on Treasury Management in the Public Services 2009, 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).

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 2011/2012 were approved by Council on 24th February 2011.

3. LINKS TO STRATEGY

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

4. THE REPORT

4.1 Treasury Management

4.2 Borrowing

4.3 <u>Loans administered by Caerphilly CBC</u>

Due to the current level of interest rates, in particular the difference between long-term borrowing rates and short-term investment rates, it is clearly still more advantageous to use internal funding in lieu of borrowing. Whilst the Annual Strategy report indicated that there would be a need to borrow in 2011/2012, a review of the balance sheet for 2010/2011 shows that the level of internal borrowing was not as high as anticipated due to a number of large earmarked reserves not yet utilised and subsequently, external borrowing could be deferred. However, as medium term (5 – 10 years) rates are predicted to remain around 3% - 4%, it may be advantageous to borrow in the current year to offset higher rates in 2012/2013.

During the period covered by this report, PWLB loans to the value of £966k. were repaid on maturity.

The portfolio's variable interest rate proportion at 31st July 2011 stood at 21.23%, which is within the Council's determination of 50%.

4.4 Rescheduling

The Annual Strategy provides for the utilisation of debt rescheduling to provide both in year and future year savings and additional revenue resources. No rescheduling opportunities presented themselves during the period covered by this report.

4.5 Loans administered by Newport City Council

These are non-PWLB loans held by the former Gwent County Council and administered by Newport City Council, which continue on a reducing basis until 2013/2014.

At the start of the financial year the amount outstanding relating to Caerphilly CBC was £213k. Repayments totalling £33k were made during the period covered by this report.

4.6 Investments

4.7 Long-term Investments

The Council no longer holds any long-term investments.

4.8 Short-term Investments (Deposits) – up to 364 Days

The value of short-term deposits at 31st July 2011 was £83.56m. and is made up of a spread of periods up to three months. The average rate for these deposits was 0.36%, which compares favourably with the target rate, as detailed in the Annual Strategy 2011/2012 report to Council, of 0.30%.

The portfolio as at 31st July comprised £9.95m (11.91%) in bank call accounts (Bank of Scotland and National Westminster - both being part-owned by the UK taxpayers), £15.5m (18.55%) in Treasury Bills (T-Bills) and £58.11 (69.54%) in the Debt Management Account Deposit Facility.

At the time of writing the balance of T-Bills has been increased to £40m (45%) with the balance held in the DMADF reducing to £38.84m (43.76%).

4.9 Strategy

Members will be aware from news reports that there is still much uncertainty in the financial markets, particularly relating to America and the EuroZone.

Whilst the Council has deposits in bank call accounts which allow instant access, recent advice from our Treasury Management consultants indicates that longer-term deposits are not recommended. Arlingclose state in their most recent update:

"However, we cannot ignore the extreme tension and negative sentiment driving the markets this week, however misguided this sentiment may be. We believe a prudent response to the tensions and negativity would be for clients to temporarily rein in maturity limits for new investments"

The Authority's investment portfolio is currently in the lowest risk category in each of the various benchmarking reports prepared by Arlingclose. Members are reminded that, whilst lowest risk will inevitably lead to lower returns, the risk to the capital sums invested are minimised. Comparative interest rates and indicative returns, including those from high credit rated banks in countries with AAA sovereign ratings, are shown in ***Appendix 1***. Members are reminded that it is not always possible to place deposits with these banks as many are not available to the Council or have minimum deposit limits of £10m/1 year (HSBC) and, therefore, are outside the parameters of the Annual Strategy.

In view of the foregoing, it is not recommended that there is any change in lending to banks at this time for anything other than the instant access that is available from Call Accounts. Due to the marginally more favourable interest that is available from Call Accounts, Members are requested to consider increasing the number of Call Accounts to 3 and increasing the limit of each Call Account to £10m.

Members will recall that a decision was taken in 2010/11 to cease lending to other local authorities as a precaution should the Comprehensive Spending Review adversely affect the ability of some local authorities to meet their budget targets and consequently default on debt repayments. As there have been no adverse reports relating to the foregoing, it would not seem imprudent for the Council to reinstate lending to other local authorities, in accordance with the Annual Strategy for 2011/2012 as approved by Council, to further enhance the rate of return achievable.

In addition, it is suggested that the maximum period for deposit of 3 months be extended to 6 months for local authorities and 9 months for T-Bills, again to further enhance the returns.

4.10 <u>Icelandic Banks</u>

Members are reminded that, to date, some £6.1m has been received in respect of Heritable Bank. This sum represents dividends totalling some 60.416% of the total amount outstanding from Heritable of £10,097,065.89 and includes the latest dividends received in April and July 2011 totalling £1,040,905.12. A further dividend is scheduled to be declared in October 2011, but, as yet, there has been no confirmation of the amount to be received.

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

Recent correspondence from the Administrators of Heritable Bank, Ernst & Young, indicate that a more favourable return for creditors is anticipated, increasing to a maximum of 90% from a maximum 85%. This has not been reflected in the Statement of Accounts for 2010/11 as changes to the anticipated returns are updated in accordance with the latest LAAP Bulletin (LAAP 82 – Update 4 – May 2011).

5. PRUDENTIAL INDICATORS

5.1 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.

In the financial year to date, the authority has been operating within the approved limits.

Appendix 3 shows the value of the Capital Financing Requirement as at 31st March 2011 as £292,132m. The Statement of Accounts are still in the process of being audited and may still be subject to audit adjustments.

5.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management remained unchanged from those previously reported, and are shown in ***Appendix 2.*** The authority is currently operating within approved limits.

5.3 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 which currently shows a variance from the original budget.

5.4 Capital Expenditure and Funding

Capital Expenditure as indicated in ***Appendix 4*** has been updated for the new Awards and the Section 106 monies.

6. FINANCIAL IMPLICATIONS

6.1 Due to the level of balances being higher than anticipated and the fact that the rate achieved (as indicated in 4.8) is higher than that assumed in the budget is likely to result in an increase in interest of some £80k on short-term deposits.

7. PERSONNEL IMPLICATIONS

7.1 There are no personnel implications.

8. RECOMMENDATIONS

8.1 Members are asked to note the report and to forward to Council to approve the update to the Strategy.

9. REASONS FOR THE RECOMMENDATIONS

9.1 Compliance with the CIPFA "Code of Practice for Treasury Management in the Public Services".

10. STATUTORY POWER

10.1 Local Government Acts 1972 and 2003.

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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 Comparative Interest Returns
Appendix 2 Treasury Management Prudential Indicators – Prudence
Appendix 3 Capital Finance Prudential Indicators – Affordability
Appendix 4 Capital Expenditure and Funding