

REPORT FOR DECISION

MEETING: CABINET
OVERVIEW & SCRUTINY COMMITTEE

DATE: 11 JULY 2012
28 AUGUST 2012

SUBJECT: 2011/12 TREASURY MANAGEMENT ANNUAL
REPORT

REPORT FROM: CABINET MEMBER FOR FINANCE & RESOURCES

CONTACT OFFICER: STEVE KENYON, ASSISTANT DIRECTOR OF
RESOURCES (FINANCE AND EFFICIENCY)

ANDREW BALDWIN, HEAD OF FINANCIAL
MANAGEMENT

TYPE OF DECISION: CABINET (KEY DECISION)

**FREEDOM OF
INFORMATION/STATUS:** This paper is within the public domain

SUMMARY: **PURPOSE/SUMMARY:**

The Council undertakes Treasury Management Activities in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, which requires that the Council receives an annual strategy report by 31 March for the year ahead and an annual review report of the previous year by 30 September. This report is the review of Treasury Management activities during 2011/12.

**OPTIONS &
RECOMMENDED OPTION**

It is recommended that, in accordance with CIPFA's Code of Practice on Treasury Management, the report be noted.

IMPLICATIONS:

**Corporate Aims/Policy
Framework:**

Do the proposals accord with the Policy
Framework? Yes

Financial Implications and Risk

As set out in the report and the comment of

Considerations: the Assistant Director of Resources (Finance and Efficiency) below.

Statement by Assistant Director of Resources (Finance and Efficiency):

This report provides information on the Council's debt, borrowing, and investment activity for the financial year ending on 31st March 2012 in conformity with the CIPFA Code of Practice for Treasury Management. The successful management of the Council's borrowing and investments is central to the Council's financial strategy, both in the short term and in ensuring a balanced debt profile over the next 25 to 60 years.

The overall strategy for 2011/12 was to finance capital expenditure by taking out temporary and short term loans (1 to 5 years) at a lower cost than more expensive long term loans. These loans would be delayed as long as it was prudent to do so with the consequence that the level of short term investments would fall. Given that investment returns would remain low at (say) 0.90% for the financial year 2011/12, then savings would be made from running down investments rather than borrowing.

Debt increased during the year, £205.621 million at 31st March 2012 compared to £137.756 million at 31st March 2011. New one-off borrowing of £78.253 million was taken in the year to finance the housing reform settlement. The average borrowing rate fell from 4.81% to 4.56% due to fall out of high coupon rate debt and new short term loans. Investments at 31 March 2012 stood at £23.881 million, compared to £36.968 million the previous year. The average rate of return on investments was 1.39% in 2011/12 compared to 1.23% in 2010/11.

Equality/Diversity implications: No - (see paragraph 8.1, page 9)

Considered by Monitoring Officer: Yes. The presentation of an annual report on Treasury Management by 30th September of the following financial year is a requirement of the Council's Financial Regulations 5.7, as part of the Council's Financial Procedure Rules and Budget and Policy framework, relating to Risk Management and Control of Resources: Treasury Management.

Are there any legal implications? No

Staffing/ICT/Property:

There are no direct staffing, ICT or property implications arising from this report.

Wards Affected:

All

Scrutiny Interest:

Overview & Scrutiny Committee

TRACKING/PROCESS**DIRECTOR: STEVE KENYON**

Chief Executive/ Strategic Leadership Team	Cabinet Member/Chair	Ward Members	Partners
Yes	Yes 11/7/12		
Scrutiny Commission		Committee	Council
Overview & Scrutiny Committee 28/8/12			

1.0 BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2009 was adopted by this Council on 24 February 2010 and this Council fully complies with its requirements. The primary requirements of the Code are the: -

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the Council of an annual strategy report for the year ahead and an annual review report of the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

1.2 Treasury management in this context is defined as:

"The management of the local authority's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

1.3 This **Annual Treasury Report** covers:

- the Council's current treasury position;
- overview of the 2011/12 strategy;

- economic review for 2011/12
- borrowing outturn for 2011/12
- investment outturn for 2011/12
- compliance with treasury limits and Prudential Indicators;

2.0 CURRENT TREASURY POSITION

2.1 The Council's debt and investment position at nominal values for the beginning and the end of 2011/12 was as follows:

	31st March 2011 Principal £'000	Average Interest Rate	31st March 2012 Principal £'000	Average Interest Rate
Fixed Rate Funding:				
- PWLB	93,109		161,362	
- Market	34,000		39,000	
- Local Bonds	3		3	
Variable Rate Funding:				
- Temporary Loans	5,000		0	
- PWLB	0		0	
- Market	0		0	
Bury MBC Debt	132,112		200,365	
Airport Debt	5,644		5,256	
Total Debt	137,756	4.81%	205,621	4.56%
Total Investments	36,968	1.23%	23,881	1.39%

3.0 OVERVIEW OF THE STRATEGY FOR 2011/12

- 3.1 The strategy for 2011/12 was to finance capital expenditure by taking out temporary loans and/or short term PWLB loans (1 to 5 years) at lower rates of interest than more expensive long term loans. These loans would be postponed as long as it is prudent to do so. One PWLB loan of £10m was repaid in the year and, in line with the strategy, has not yet been replaced. Apart from 3.2 below, all other borrowing in the year comprised temporary short term loans. As investment returns were low during 2011/12, savings were made by running down investments to finance capital expenditure.
- 3.2 In order to finance the housing reform settlement paid to the Department for Communities and Local Government, the Council took out 3 long term PWLB loans amounting to £78.253m in total. These loans were able to be taken at special low rates of interest.
- 3.3 As a result of 3.1 above, the Council was able to lower the average interest rate on debt from 4.81% to 4.56% and was able to achieve an average interest rate on investments of 1.39% for 2011-12 (which compares with Sector's target rate of 0.90%).
- 3.4 Due to poor investment returns, investment balances were kept low during the year and consequently there was a reduction in exposure to counterparty and interest rate risk on the investment portfolio.

4.0 ECONOMIC REVIEW FOR 2011/12

- 4.1 The financial year 2011/12 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened levels of counterparty risk. The original expectation for 2011-12 was that Bank Rate would start gently rising from quarter 4 2011. However, GDP growth in the UK was disappointing during the year under the weight of the UK austerity programme, a lack of rebalancing of the UK economy to exporting and weak growth in our biggest export market - the EU. The EU sovereign debt crisis grew in intensity during the year until February when a second bailout package was eventually agreed for Greece. 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% but then fell to 3.4% in February, with further falls expected to below 2% over the next two years.
- 4.2 **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 quantitative easing during the year, combined to depress PWLB rates to historically low levels.
- 4.3 **Investment rates.** 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 ratings of many banks and sovereigns, continued Eurozone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment.

5.0 BORROWING OUTTURN FOR 2011/12

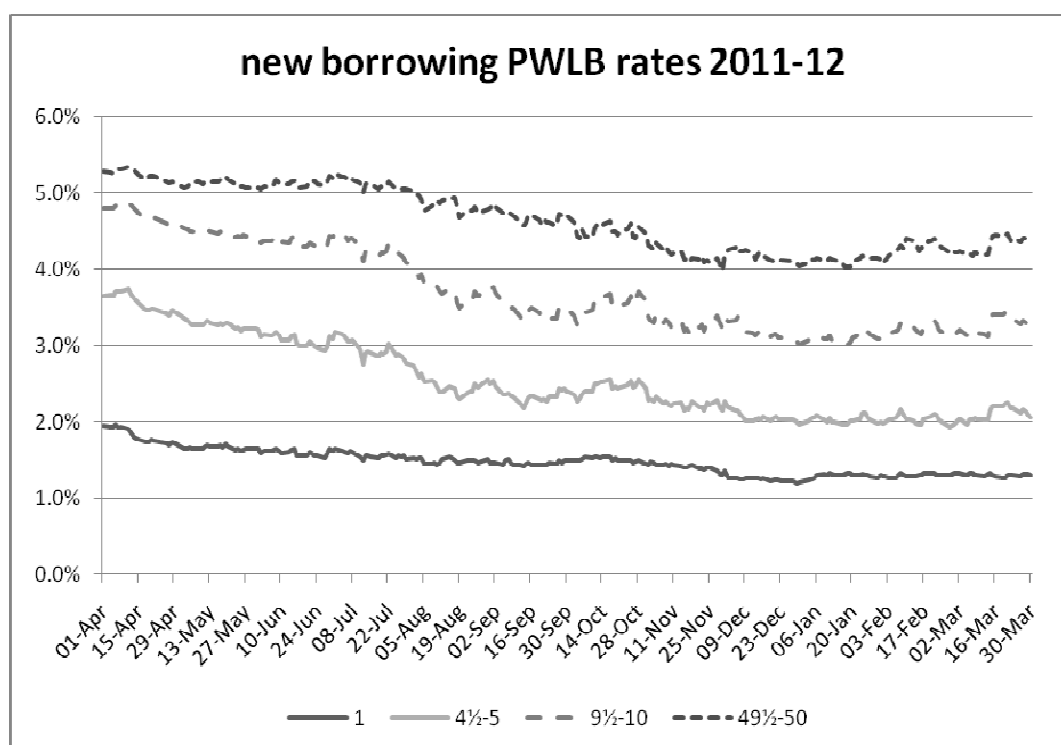
- 5.1 The Council's ability to borrow is determined by the cumulative capital financing requirement (CFR). When the cumulative CFR is compared to outstanding debt the difference is the amount of headroom still available to borrow. At the end of 2011/12 debt stood at £205.621m and the CFR at £248.196m. Therefore, in theory, borrowing of £42.575m could be taken to finance past and present capital expenditure.
- 5.2 An analysis of movements at nominal values on loans during the year is shown below:

	Balance at	Loans	Loans	Balance
	31.3.11	Raised	Repaid	31.03.12
	£000s	£000s	£000s	£000s
PWLB	93,109	78,253	(10,000)	161,362
Market	34,000	5,000	0	39,000
Temporary Loans	5,000	21,300	(26,300)	0
Other loans	3	0	0	3
Bury MBC Debt	132,112	104,553	(36,300)	200,365
Airport PWLB Debt	<u>5,644</u>	<u>0</u>	<u>(388)</u>	<u>5,256</u>
Total Debt	<u>137,756</u>	<u>104,553</u>	<u>(36,688)</u>	<u>205,621</u>

- 5.3 The approach during 2011/12 was to take advantage of rates when they were at their lowest and identify debt rescheduling opportunities. Unfortunately, there were no opportunities to make savings through debt rescheduling in 2011/12.
- 5.4 The implementation of housing finance reform at the end of the year abolished the housing subsidy system financed by central government and, consequently, all housing debt has been reallocated nationally between housing authorities. The result of this reallocation is that this Council made a capital payment to the Department of Communities and Local Government of £78.253m. This resulted in an increase in the CFR and the whole amount was financed by new external borrowing consisting of 3 long term PWLB loans at special low rates of interest.
- 5.5 In line with the strategy, the Council delayed borrowing as long as possible by running down short term investments. When it was time to borrow, temporary short term loans were taken in preference to more expensive long term loans. One PWLB loan was repaid in the year, and, in line with the strategy, has not yet been replaced. By maintaining borrowing at short term rates, the Council was able to minimise any corresponding risk from holding short term investments. As the year progressed further borrowing was kept to a minimum and cash balances were used to finance new capital expenditure. Therefore counterparty risk incurred on investments was minimised. This also maximised treasury management budget savings as investment rates were much lower than most new borrowing rates.
- 5.6 The active monitoring of the debt portfolio, the full year effect of previous rescheduling of loans, and the taking of new loans at historically low rates, have decreased the average Interest rate on the debt held over time:

Year	05/06	06/07	07/08	08/09	09/10	10/11	11/12
Average Interest Rate on Debt	5.85%	5.50%	5.40%	5.33%	4.98%	4.81%	4.56%

- 5.7 From 2005/06 the average interest rate falls over time due to rescheduling of loans to lower interest rates and the borrowing of new loans at historically low levels.
- 5.8 The Council's policy on the fall out of debt has been to establish a debt profile where the amount of debt due to be refinanced each year is stable and large scale financing in any one year avoided. Market LOBO (Lenders Option Borrower's Option) loans are recorded in accordance with the regulations set down in the Prudential Code which states "the maturity of borrowing should be determined by reference to the earliest date on which the lender can require payment".
- 5.9 PWLB borrowing rates - the graph below shows how PWLB rates fell to historically very low levels during the year.



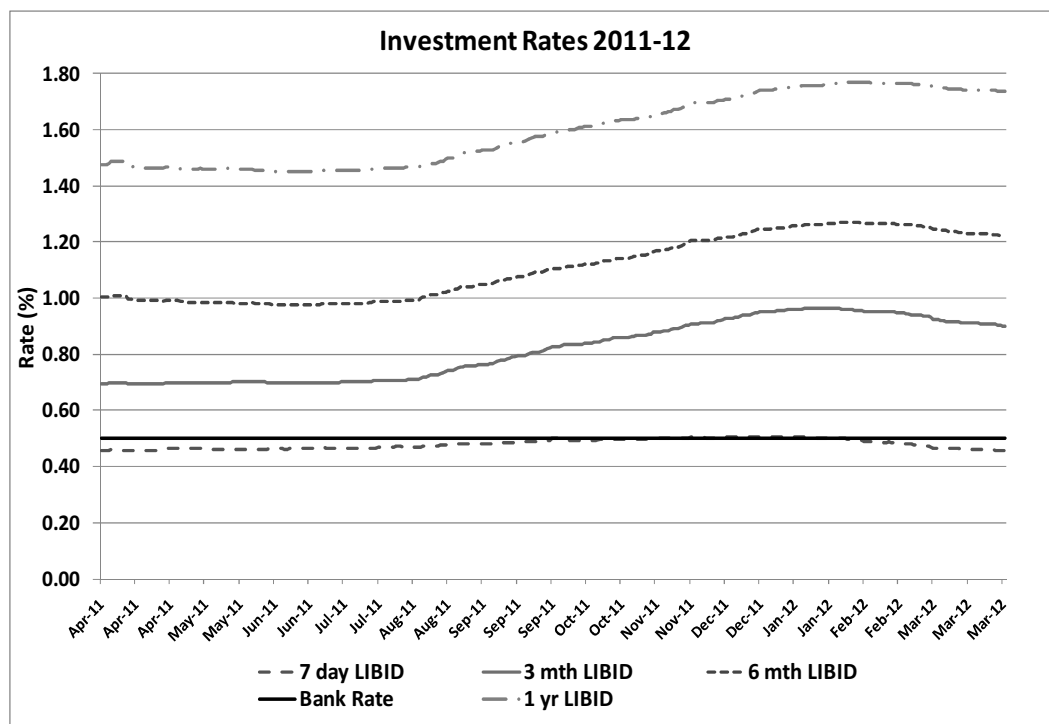
6.0 INVESTMENT OUTTURN FOR 2011/12

- 6.1 The Council manages its investments in-house (with advice from Sector) with the overall objective to balance risk with return and the overriding consideration being given to the security of the available funds.
- 6.2 Surplus funds have been invested with institutions listed in the Council's approved lending list. When making investment decisions, the Council has regard to the Guidance on Local Government Investments issued by the DCLG and CIPFA's Treasury Management Code of Practice.
- 6.3 Institutions in which investments were made did not have any difficulty in repaying investments and interest in full during the year, reflecting the sound risk management activities undertaken by the treasury team.
- 6.4 The investment strategy for 2011/12 approved by Council in February 2011 forecast the bank rate to stay flat at 0.50% throughout the year. The average rate on investments for the year was 1.39% which is in line with Sector's initial target rate of 0.90%.
- 6.5 The strategy also recognised that the Council's funds would be mainly cash-flow driven. The Council would seek to utilise business reserve accounts and short dated deposits in order to benefit from the compounding of interest.
- 6.6 Detailed below is the result of the investment strategy undertaken by the Council.

	Average Investment	Rate of Return	Benchmark Return *
Internally Managed	£44,187,205	1.39%	0.48%

* the benchmark return is the average 7-day London Interbank Bid (LIBID) rate (uncompounded) sourced from the Financial Times

- 6.7 Investments at 31 March 2012 stood at £23.881m (£36.968m at 31 March 2011), whilst the average for the year was £44.187m (£52.850m at 31 March 2011). The decrease in the weighted average investments from 2010/11 to 2011/12 reflects the strategy to run down investments in the second half of the year to fund capital expenditure rather than borrow to fund capital spending.
- 6.8 Total interest earned on investments in the financial year was £0.597 million compared to £0.610 million in 2010/11. This reflects the fact that investment returns were poor throughout the year. Consequently cash balances were used to finance new capital expenditure to maximise budget savings as investment rates were much lower than new borrowing rates.
- 6.9 Investment rates in 2011/12. The tight monetary conditions following the 2008 financial crisis continued through 2011/12 with little material movement in the shorter term deposit rates. However, one-month and longer rates rose significantly in the second half of the year as the Eurozone crisis grew. Bank Rate remained at its historic low of 0.5% throughout the year while market expectations of the imminence of monetary tightening were gradually pushed further and further back during the year to the second half of 2013 at the earliest.
- 6.10 Overlaying the relatively poor investment returns were the continued counterparty concerns generated by the Eurozone sovereign debt crisis.



7.0 COMPLIANCE WITH TREASURY LIMITS

- 7.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out the Council's Treasury Policy Statement and annual Treasury Management Strategy Statement. The outturn for the Prudential Indicators is shown in Appendix 1.

8.0 EQUALITY AND DIVERSITY

8.1 There are no specific equality and diversity implications.

9.0 FUTURE ACTIONS

9.1 Treasury Management Updates and Prudential Indicators for 2012/13 will be presented on a quarterly basis to the Cabinet and the Overview & Scrutiny Committee.

10.0 CONCLUSION

10.1 It is recommended that Members note the treasury management activity that has taken place during the financial year 2011/12.

Councillor Tony Isherwood
Cabinet Member for Finance and Resources

Background documents:

Unaudited Final Accounts Bury MBC 2011/12
CIPFA Treasury Management Code of Practice in the Public Services
CIPFA The Prudential Code for Capital Finance in Local Authorities
Sector's Annual Treasury Management Report 2011-12
Financial markets and economic briefing papers

For further information on the details of this report and copies of the detailed variation sheets, please contact:

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Prudential Indicators 2011/12

Appendix 1

The key objectives of the Prudential Indicators are to ensure that the Council's capital investment plans and treasury management decisions are affordable, prudent and sustainable or in exceptional cases to highlight if this is not achievable. The prudential indicators for 2011/12 were not breached and were kept within their limits.

The table below shows the Prudential Indicators for 2011/12.

CAPITAL EXPENDITURE	Original Budget 2011/12 £'000	Actual Outturn 2011/12 £'000	Variance
Estimate of Capital Expenditure			
Non-HRA	11,317	21,558	90.49%
HRA	4,994	5,016	0.44%
Housing Reform settlement	0	78,253	
TOTAL	16,311	104,827	
Estimate of Capital Financing Requirement (CFR)			
Non-HRA	136,729	129,412	(5.35%)
HRA existing expenditure	40,887	40,531	(0.87%)
Housing Reform settlement	0	78,253	
	177,616	248,196	
AFFORDABILITY	Original Budget 2011/12	Actual Outturn 2011/12	Variance
Estimate of incremental impact of capital investment decisions			
Increase in council tax (band D, per annum)	£3.47	£0.00	
Increase in housing rent per week	£0.00	£0.00	
Ratio of Financing Costs to net revenue stream			
Non-HRA	2.68%	2.32%	(13.43%)
HRA	6.95%	5.82%	(16.26%)
Net External Borrowing only to support the CFR in Medium Term	£'000	£'000	
Net External borrowing over medium term	139,990	205,621	
Total CFR over Medium Term	174,553	248,196	
Net External Borrowing < Total CFR	TRUE	TRUE	
EXTERNAL DEBT	Original Budget 2011/12 £'000	Actual Outturn 2011/12 £'000	Variance
Authorised limit of external debt			
Borrowing	214,500	214,900	0.19%
Other long term liabilities	7,400	7,400	0.00%
Housing Reform Settlement	0	79,258	

TOTAL	221,900	301,558	
Operational boundary			
Borrowing	189,400	189,800	0.21%
Other long term liabilities	7,400	7,400	0.00%
Housing Reform Settlement	0	79,258	
TOTAL	196,800	276,458	

TREASURY MANAGEMENT	Original Budget 2011/12	Actual Outturn 2011/12	Variance
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments	140%	140%	0%
Upper limit for variable rate exposure Net principal re variable rate borrowing / investment	-40%	-40%	0%
Upper limit for total principal sums invested for 364 days	£10 m	£10 m	
Maturity structure of fixed rate borrowing 2011/12	Upper/lower limit	Actual	
Under 12 months	10% - 0%	3.86%	
12 months and within 24 months	35% - 0%	3.78%	
24 months and within 5 years	40% - 0%	7.74%	
5 years and within 10 years	50% - 0%	6.81%	
10 years and above	90% - 30%	77.81%	

The prudential indicators of affordability listed above address the revenue implications of the authority's finances since, as a fundamental principle, all borrowings are secured on the authority's future revenue income. The CIPFA Prudential Code requires the prudential indicators in respect of external debt, as above, to be set and revised taking into account their affordability. It is through this means that the objectives of sustainability and prudence are addressed each year.