CYNGOR SIR *POWYS* COUNTY COUNCIL

MODERNISATION & IMPROVEMENT
2nd September 2011

CABINET
13th September 2011

AUDIT COMMITTEE
29th September 2011

REPORT BY:	**CLLR. TONY THOMAS** **PORTFOLIO HOLDER FOR FINANCE**
SUBJECT:	**TREASURY MANAGEMENT REVIEW 2010/11**

REPORT FOR: **Approval**

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1. Introduction:

1.1 The Council's Treasury Management Policy as per the CIPFA Code of Practice requires an annual report on Treasury Management activity to be approved by Cabinet by 30th September each year.

1.2 Treasury Management in this context is defined as:
"The management of the 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."

2. Strategy for 2010/11

2.1 At the start of 2010/11 the Authority had a Capital Financing Requirement of £192.9m, projected to rise by £17.2m during the course of the next three years to £210.1m. An increase in the CFR may not necessarily lead to any additional borrowing, as the debt liability can be met from an authority's resources (commonly known as internal borrowing). The Authority's external borrowing at 1st April 2010 stood at £159.9m. Analysis of the balance sheet at 31st March 2010 showed that the Authority was internally borrowed by £9M.

2.2 The expectation for interest rates within the strategy for 2010/11 anticipated low but rising Bank Rate (starting in Qtr 4 of 2010) with similar gradual rises in medium and longer term fixed interest rates over 2010/11. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be denominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

2.3 The Authority had no particular requirement to externally borrow in 2010/11. However, should a need have arisen, the agreed strategy at the start of the year, based on interest rate forecasts and discussions with Sector (the Authority's advisors), was to set a benchmark of 2.9% for < 5 year borrowing, 4.2% for 5 to 10 year borrowing, 4.65% for 10 to 25 year borrowing and 4.65% for 25 to 50 year borrowing. This was revised during the year to 2.2% for < 5 year borrowing, 3.3% for 5 to 10 year borrowing and 4.2% for 10 to 25 year borrowing and 25 to 50 year borrowing.

2.4 In light of the continuing stress on the world banking system, enhanced priority was given to the security and liquidity of investments.

The strategy for investments therefore was:

a) to ensure the security of the Authority's funds
b) to ensure the Authority had sufficient liquidity to meet its cashflow requirements
c) to achieve the optimum yield after ensuring a) and b) above.

3. Treasury Position

3.1 The major issue for Treasury Management in 2010-11 was the continuing challenging environment of previous years i.e. low investment returns and continuing counterparty risk which meant giving heightened preference to security and liquidity of investments. This resulted in the investment portfolio being in investment instruments with lower rates of return but higher security and liquidity.

3.2 In order to balance the impact of the loss in investment income the Authority was mindful of not replacing maturing debt and also the possibility of making premature repayments of debt if circumstances were conducive to this.

As such, net borrowing decreased by £6.366M over the year.
This decrease arose as follows:

	£000s
Decrease in PWLB debt	(14,011)
Increase/Decrease in LOBO debt	NIL
Decrease in Investments	7,645
	(6,366)

3.3 The table below summarises the borrowing and investment transactions during the year:

	Balance 01-04-10	**Borrowing**	**Investments**	**Repayments**	**Balance 31-03-11**
	£000's	**£000's**	**£000's**	**£000's**	**£000's**
PWLB *	119,854	Nil	N/A	(14,011)	105,843
LOBOs *	40,000	Nil	N/A	Nil	40,000
Temporary Borrowing	Nil	Nil	N/A	Nil	Nil
Total	159,854	Nil	N/A	(14,011)	145,843
Temporary Investments	(32,205)	N/A	(298,290)	303,935	(26,560)
Long Term Investments	(7,000)	N/A	Nil	2,000	(5,000) Now short term
Net Borrowing	120,649	Nil	(298,290)	291,924	114,283

Note: * Public Works Loan Board / Lender's Option Borrower's Option

3.4 A summary of the economy and interest rates for 2010/11 is at Appendix A.

4. Icelandic Banks

4.1 The investment figures above do not include the £4M deposits held in Icelandic banks Glitnir and Landsbanki.

4.2 The latest update is that the Icelandic courts have initially confirmed that deposits enjoy preferential creditor status. However, this is currently subject to appeal, a decision on which is expected by September 2011. If preferential creditor status is upheld the estimated return is 100% Glitnir and 94.85% Landsbanki.

5. Balance Sheet Review

5.1 The Authority's advisors carry out an annual balance sheet review following closure of the accounts. This provides, amongst other things, information as to the internal/external borrowing position of the Authority and hence, its future need to borrow.

5.2 The review for 2010/11 has revealed that the Authority is under borrowed at 31st March 2011 by £49.8M (26% of the Capital Financing Requirement) compared to £35.6M at 31st March 2010 (18% of the Capital Financing Requirement). Internal investments in the balance sheet (showing that the Authority is internally borrowed) at 31st March 2011 were £30.2M compared to £8.8M at 31st March 2010.

6. Debt Rescheduling/Repayment

6.1 At the start of 2010/11 the expectation was that investment rates were expected to continue to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

6.2 However, short term savings by avoiding new long term external borrowing in 2010/11 would need to be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.

6.3 The Authority continued to monitor the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt positions but PWLB interest rates throughout the year were not conducive to this. However, the Authority did not replace £14M of debt that matured during the year.

7. Performance Measurement

7.1 Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide.
In this context, the overall average rate of interest paid on all debt in 2010/11 was 4.59%. This compared with 4.39% in 2009/10. The increase transpired as £9M of the £14M maturing debt was at interest rates below 2%.

7.3 The Treasury Management Policy stipulates that the Average Rate on External Investments should be compared with the 3-month uncompounded LIBID rate. This is in preference to the 7-day uncompounded LIBID rate and is in line with Sector's advice, as it reflects a more realistic neutral investment position for core investments with a medium-term horizon and a rate which is more stable with less fluctuations caused by market liquidity. Historically, the 3-month rate has been slightly higher than the 7-day rate and is, therefore, more challenging for the cash manager.

7.4 In 2010/11 the average rate on external investments achieved was 0.85% compared with the 3 month uncompounded LIBID rate of 0.69%.

8. Summary Statement of Accounts

8.1 The Treasury Management Policy Statement stipulates that a summary Statement of Accounts for Treasury Management be produced at the year end and reported as part of the annual review (see Appendix B).

9. Prudential Indicators

9.1 During the year the Authority operated the treasury limits as approved by Council. The Prudential Indicator for the operational boundary for external debt was over limit at the start of the year prior to the first £5M debt maturity. However, the operational boundary is set as a challenging figure and is able to be over limit although the situation should be reviewed if this happens on a regular or consistent basis. No other indicators were breached.

10. Member Training

10.1 The CIPFA Code of Practice states that members charged with governance (all members as the annual strategy requires approval by Full Council) have a personal responsibility to ensure that they have the appropriate skills and training for their role. As such, the Authority provided two members' training sessions for treasury management in 2010/11.

11. Treasury Management Policy Statement

11.1 Any major changes to the Treasury Management Policy Statement are reported to Cabinet whilst any minor changes are circulated to members via the members' portal. The Statement is available on the Intranet at:

http://intranet.powys.gov.uk/index.php?id=4585

12. Treasury Management – Banking

12.1 The Treasury Management section manages the Authority's corporate bank accounts. In 2010/11 all bank account reconciliations were completed on a timely basis and an internal audit report on Bank Reconciliation gave a Full Assurance.

13. Projects

13.1 The Treasury Management section led or was involved in several projects throughout the year including the further roll out of e-returns (electronic paying-in slips) to establishments and schools; the introduction of corporate direct debits; bar coding of invoices to enable payment at Post Offices and a review of cash in transit services. Several of these projects are continuing into 2011/12.

Proposal

It is proposed that the Treasury Management Review Report is approved.

Statutory Officers

Chief Finance Officer's comment:

"The CFO supports the recommendation of the report".

Future Status of the Report

Not applicable

<table>
<tr><td colspan="2">Recommendation:</td><td colspan="2">Reason for Recommendation:</td></tr>
<tr><td colspan="2">The contents of this report are approved.</td><td colspan="2">Statutory requirement</td></tr>
<tr><td colspan="2">Person(s) To Action Decision</td><td colspan="2"></td></tr>
<tr><td colspan="2">Date By When Decision To Be Actioned:</td><td colspan="2"></td></tr>
<tr><td>Relevant Policy (ies):</td><td colspan="3">Financial Regulations, Treasury Management Policy</td></tr>
<tr><td>Within Policy:</td><td>Y</td><td>Within Budget:</td><td>N/A</td></tr>
<tr><td>Contact Officer Name:</td><td>Tel:</td><td>Fax:</td><td>Email:</td></tr>
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Background Papers used to prepare Report:

Treasury Management Policy Statement
CIPFA Code of Practice on Treasury Management and Cross Sectoral Guidance Notes
Advisor's Papers

Appendix A:

The Economy and Interest Rates

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.

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.

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.

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.

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.

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.

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.

PWLB Borrowing Rates in 2010/11:

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.

Years	I yr	1½-2	2½-3	3½-4	4½-5	9½-10	24½-25	49½-50	1 month variable
01.04.10	0.81	1.37	1.91	2.40	2.84	4.14	4.62	4.65	0.65
31.03.11	1.87	2.34	2.79	3.21	3.57	4.71	5.32	5.25	1.57
High	1.99	2.51	3.00	3.44	3.83	4.99	5.55	5.48	1.57
Low	0.60	0.88	1.18	1.50	1.82	3.06	3.92	3.93	0.65
Average	1.18	1.59	2.01	2.41	2.79	4.05	4.77	4.76	1.05
Spread	1.39	1.63	1.82	1.94	2.01	1.93	1.63	1.55	0.92

Investment Rates in 2010/11:

	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

Appendix B

Statement of Accounts
Treasury Management

		2010/11	2010/11	2009/10
		Actual	Budget	Actual
		£	**£**	**£**
Employees		190,480	219,180	229,282
Transport	*1	314,279	402,041	380,836
Supplies & Services		181,618	199,605	202,361
Interest Paid		7,031,436	7,058,740	7,339,746
Debt Management Expenses		0	6,000	4,038
Gross Expenditure		**7,717,813**	**7,885,566**	**8,156,263**
Interest Received	*2	424,700	268,080	637,596
Gross Income		**424,700**	**268,080**	**637,596**
Net Expenditure		**7,293,113**	**7,617,486**	**7,518,667**

Note 1: Transport relates to the cost of leasing across the Authority and is included in the Treasury Management Statement of Accounts as leasing is classed as a Treasury Management activity. Budgeted leasing did not go ahead during the year resulting in the £88k underspend.

Note 2: A surplus of £157k on interest received was achieved as interest rates for fixed investments and Money Market Funds were slightly higher than expected throughout the year and the Authority continued to benefit from good deposit account rates that it had thought would be withdrawn.