AGENDA MANAGEMENT SHEET

Name of Committee	**Overview and Scrutiny Board**
Date of Committee	**20 July 2011**
Report Title	**Treasury Management Outturn Report 2010/11**
Summary	This report sets out the outturn of the treasury management process during 2010/11.
For further information please contact:	Phil Triggs Group Manager Tel: 01926 412227 philtriggs@warwickshire.gov.uk
Would the recommended decision be contrary to the Budget and Policy Framework? [please identify relevant plan/budget provision]	No.
Background papers	• CIPFA publication "Treasury Management in the Public Services: Code of Practice and Guidance notes for Local Authorities” • Treasury Management Strategy 2010/11

CONSULTATION ALREADY UNDERTAKEN:- Details to be specified

Other Committees	☐	....
Local Member(s)	☐	
Other Elected Members	☐	Cllr Appleton, Cllr Roodhouse, Cllr Tandy – for information
Cabinet Members	☒	Cllr Wright
Chief Executive	☐	....
Legal	☒	John Galbraith
Finance	☒	John Betts, County Treasurer – reporting officer
Other Chief Officers	☐	....
District Councils	☐	....

Health Authority	☐	....
Police	☐	....
Other Bodies/Individuals	☐	Michelle McHugh, Overview and Scrutiny Manager

FINAL DECISION YES

SUGGESTED NEXT STEPS:

		Details to be specified
Further consideration by this Committee	☐	....
To Council	☐	....
To Cabinet	☐	....
To an O & S Committee	☐	....
To an Area Committee	☐	....
Further Consultation	☐	....

Agenda No 6

Overview and Scrutiny Board

Treasury Management Outturn Report 2010/11

Recommendation

That the Board considers and comments on the annual Treasury Management outturn report.

1 Introduction

1.1 Warwickshire County Council fully complies with the requirements of The Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice (COP) on Treasury Management 2009. The primary requirements of the Code are the:

- creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;
- creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;
- receipt by the Cabinet of an annual treasury management strategy report for the year ahead, a midyear review report (as a minimum) and an annual review report of the previous year;
- 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 Therefore, under the CIPFA Code, the Authority is required to receive a report on the outturn of the annual treasury management activity.

1.3 Treasury management in the context of this report 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." *(CIPFA Code of Practice)*.

1.4 This annual treasury outturn report covers:

- Council's Current Treasury Position — Section 2
- Performance Measurement — Section 3
- Treasury Management Strategy for 2010/11 — Section 4
- The Economy and Investment Rates in 2010/11 — Section 5
- Borrowing Outturn for 2010/11 — Section 6
- Compliance with Treasury Limits and Prudential Indicators — Section 7
- Investment Outturn for 2010/11 — Section 8
- Debt Rescheduling for 2010/11 — Section 9

2 Council's Current Treasury Position

2.1 The Council raises long-term borrowing to fund capital expenditure, i.e., expenditure on land, buildings and equipment. At 31 March 2010, the Council had £335.8m of long-term borrowing and this had increased to £371.7m by 31 March 2011 as detailed in section A in Table 1.

2.2 At the same time as borrowing for capital purposes, the Council also has an investment portfolio. This consists of the Council's reserves and short-term cash flows. This cash was invested partly by an external cash manager and partly in house. As at 31 March 2010, the Council had £91.7m of cash investments and this had increased to £116.6m by 31 March 2011 as detailed in section B of Table 1.

2.3 The Council's debt and investment position at the beginning and the end of the year was as follows:

Table 1: Summary of Treasury Position at 31 March 2011

	Principal at 31.03.10	**Rate/ Return**	**Principal at 31.03.11**	**Rate/ Return**
A: Fixed Rate Funding	£m	%	£m	%
Public Works Loans Board Debt	335.8	5.28	371.7	4.72
Total Debt	**335.8**	**5.28**	**371.7**	**4.72**
B: Investments				
In House	46.7	0.92	70.9	0.45
External Managers	45.0	5.04	45.7	1.62
Total Investments	**91.7**	**2.54**	**116.6**	**0.87**

3 Performance Measurement

3.1 One of the key changes in the last revision of the CIPFA Code was the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide (as incorporated in Table 1).

4 Treasury Management Strategy for 2010/11

4.1 Our treasury strategy for 2010/11 was approved by Cabinet on 25 February 2010 and then Council on 30 March 2010.

4.2 The expectation for interest rates within the strategy for 2010/11 anticipated a low but rising Bank Rate (starting in Q4 of 2011) with similar gradual rises in medium and longer term fixed interest rates over 2011/12. 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 dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

4.3 In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and reduce counterparty risk. The actual movement in interest rates broadly followed the expectations in the strategy, as detailed in the following sections.

5 The Economy and Investment Rates in 2010/11

5.1 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.

5.2 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. The Japanese disasters in March and the African uprising in the spring, especially the situation in Libya, caused an increase in world oil prices, which all combined to dampen international economic growth prospects.

5.3 Spending cuts announced in the October 2010 Comprehensive Spending Review, and the lack of any "giveaway" in the March 2011 Budget have led commentators to point to uncertain domestic growth expectations.

5.4 Gilt yields fell for much of the first half of the year as financial markets drew reassurance from the Government's debt reduction plans, especially in the light of Euro zone sovereign debt concerns. 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 the Bank Rate earlier than previously expected.

5.5 The developing Euro zone peripheral sovereign debt crisis caused considerable concerns in financial markets. First Greece (May 2010), then Ireland (December 2010), were forced to accept assistance from a combined EU/IMF rescue package. These worries caused international investors to seek safe havens in investing in non-Euro zone government bonds.

5.6 Deposit rates picked up 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 the Bank Rate. 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 the 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.

5.7 Risk premiums were also a factor in raising money market deposit rates beyond three 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.

6 Borrowing Outturn for 2010/11

6.1 The Council undertook PWLB borrowing totalling £40m during 2010/11 at rates significantly below its target rate. Details are as follows:

Date Commenced	£m	Rate %	Maturity Date
9/7/2010	10	2.74	30/9/2016
9/7/2010	10	2.88	31/3/2017
3/9/2010	10	2.99	30/9/2019
3/9/2010	10	3.95	31/3/2060

6.2 As comparative performance indicators, average PWLB maturity loan interest rates for 2010/11 were:

1 year	1.86%
9.5 - 10 year	4.04%
25 - 30 year	4.78%
49.5 - 50 year	4.76%

7 Compliance with Treasury Limits and Prudential Indicators

7.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Treasury Management Strategy.

7.2 Table 2 compares actual performance against the 2010/11 borrowing limits and shows that all treasury activity was conducted within the set limits.

Table 2: Actuals Compared with Strategy Limits 2010/11

	Limit	**Actual**
Authorised Limit for External Debt	£489.2m	£371.7m
Upper Limit for Interest Rate Exposure	100%	100%
Upper Limit for Variable Rate Exposure	25%	0%
Upper Limit for total principal sums invested for over 365 days	£0	£0
Maturity Structure of Fixed Rate borrowed during 2010/11		
Under 12 months	0-20%	0%
12 months and within 24 months	0-20%	0%
24 months and within 5 years	0-60%	0%
5 years and within 10 years	0-100%	75%
10 years and above	0-100%	25%

7.3 Full details of the prudential indicators set for 2010/11 and the results for the year are shown in **Appendix A.**

8 Investment Rates 2010/11

8.1 The tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in the shorter term deposit rates. The 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.

8.2 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.

9 Investment Outturn for 2010/11

9.1 The Council's investment policy is implemented in the annual investment strategy. 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, FT reports, etc.) The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

9.2 The Council manages its short-term cash balances in-house and invests with the institutions listed in the Council's approved lending list. The Council invests for a range of periods from overnight to two years, dependent on the Council's cash flows, its interest rate view and the interest rates on offer. Table 3 summarises the investment performance for 2010/11.

Table 3: Investment Outturn 2010/11

	Average balance of Investments £m	Rate of Return %	Benchmark Return %
Internally Managed	£80.2	0.45	0.43
Externally Managed	£45.3	1.62	0.47

9.3 Reserves and long-term cash balances are placed with an external cash manager, Aviva Investors, who invests in a wide range of investment instruments. The fund management agreement between the Council and the Fund Manager defines the limits for maximum weighting in gilts/bonds and maximum duration of the fund. Counterparty criteria and exposure limits are also pre-defined within the agreement.

9.4 Aviva's performance target was to out-perform the 7-day investment rate by 10% of the benchmark rate. During 2009/10, Aviva achieved a return of 1.62%. This is substantially above its target of 0.47% (7-day investment benchmark rate of 0.43% + 10% of the benchmark).

9.5 No institutions in which investments were made had any difficulty in repaying investments and interest in full during the year.

10 Debt Rescheduling for 2010/11

10.1 No debt rescheduling was undertaken in 2010/11.

Report Author: Phil Triggs, Group Manager (Treasury and Pensions)

Head of Service: John Betts, County Treasurer

Strategic Director: David Carter, Strategic Director, Resources Group

Portfolio Holder(s): Cllr Wright, Portfolio Holder, Finance

Appendix A

PRUDENTIAL INDICATOR (1). AFFORDABILITY PRUDENTIAL INDICATORS	2010/11 outturn	2011/12 estimate	2012/13 estimate	2013/14 estimate	2014/15 estimate
	£'000	£'000	£'000	£'000	£'001
Capital Expenditure	89,194	124,493	55,111	37,848	20,250
	%	%	%	%	%
Ratio of financing costs to net revenue stream	10.92	10.76	11.29	11.14	11.13
Net borrowing requirement	£'000	£'000	£'000	£'000	£'001
brought forward 1 April	335,751	371,701	401,993	407,443	411,036
carried forward 31 March	371,701	401,993	407,443	411,036	410,142
in year borrowing requirement	35,950	30,291	5,450	3,593	(894)
	£'000	£'000	£'000	£'000	£'001
In year Capital Financing Requirement	16,457	30,291	5,450	3,593	(894)
	£'000	£'000	£'000	£'000	£'001
Capital Financing Requirement as at 31 March	374,133	404,425	409,874	413,468	412,574
Affordable Borrowing Limit	£	£	£	£	£
Position as agreed at March 2011 Council					
Increase per council tax payer	17.02	6.21	13.79	1.87	0.82
Updated position of Current Capital Programme					
Increase per council tax payer	15.22	8.19	12.14	2.09	0.62

PRUDENTIAL INDICATOR (2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2010/11 approved	2011/12 estimate	2012/13 estimate	2013/14 estimate	2014/15 estimate
Authorised limit for external debt -	£'000	£'000	£'000	£'000	£'001
Borrowing	489,204	482,451	491,994	496,909	495,240
other long term liabilities	12,000	12,000	12,000	12,000	12,000
TOTAL	**501,204**	**494,451**	**503,994**	**508,909**	**507,240**
Operational boundary for external debt -	£'000	£'000	£'000	£'000	£'001
Borrowing	407,670	402,043	409,995	414,091	412,700
other long term liabilities	10,000	10,000	10,000	10,000	10,000
TOTAL	**417,670**	**412,043**	**419,995**	**424,091**	**422,700**
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
Net principal re variable rate borrowing / investments	25%	25%	25%	25%	25%
Upper limit for total principal sums invested for over 364 days	£	£	£	£	£
(per maturity date)	£0	£0	£0	£0	£0

Maturity structure of new fixed rate borrowing during 2011/12	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%