CABINET **21 JULY 2011**

TREASURY MANAGEMENT ANNUAL REPORT 2010/11
(Report by the Head of Financial Services)

1. INTRODUCTION

1.1 Council approves the Treasury Management strategy for the forthcoming year when it approves the budget and MTP each February. It also receives a mid-year report and an annual report after the end of the financial year. The Council's Strategy also requires scrutiny of the Treasury Management function to be carried out by the Economic Well-being Scrutiny Panel.

1.2 The Council approved the 2010/11 treasury management strategy at its meeting on 17th February 2010. The key points were:

- to invest any available funds in a manner that balanced low risk of default by the borrower with a fair rate of interest.
- to ensure it had sufficient cash to meet its day-to-day obligation
- to borrow when necessary to fund capital expenditure and to borrow in advance if rates were considered to be low.

2. ECONOMIC REVIEW

2.1 The absence of a quick economic recovery led to rising government budget deficits, especially in the European periphery, and prompted some concern among bond investors and credit rating agencies. This loss of confidence in the ability of some governments to repay their debts saw bond yields rise and the markets effectively closed to certain countries. Greece, Ireland and Portugal were all forced to seek financial assistance from the European Union and the International Monetary Fund.

2.2 The UK's deteriorating financial position was also a concern. The UK had the highest budget deficit in the EU in 2009/10 and the economic outlook was weak. However, the new Conservative-Liberal Democrat coalition government outlined what was perceived by investors and credit rating agencies to be a credible fiscal consolidation plan. With financial problems continuing elsewhere in Europe, the UK was perceived to be a relative "safe haven", and strong appetite for UK government debt kept gilt yield low.

2.3 While the UK government focused on tightening fiscal policy, the Bank of England maintained loose monetary policy. Bank Rate remained at 0.5% throughout the financial year, despite inflation rising to over double the 2% target as the price of raw materials increased. With inflation expected to reach 5% during 2011, heightening the risk that raised inflation expectations would feed into wages and prices, three members of the

Monetary Policy Committee voted for a rise in Bank rate in February. The remaining six members, however, were more concerned that higher interest rates could choke off the economic recovery, which was already showing signs of slowing in response to fiscal tightening. The MPC remains divided on when to raise the Bank Rate.

3. PERFORMANCE OF FUNDS

3.1 The following table summarises the treasury management transactions undertaken during the 2010/11 financial year:

	Principal Amount £m	Interest Rate %
Investments		
at 31st March 2010	20.0	3.75
less matured in year	-152.8	
plus arranged in year	+148.3	
at 31st March 2011	15.5	3.50
Average Investments	**28.3**	**2.64**
Borrowing		
at 31st March 2010	14.6	2.82
less repaid in year	-42.6	
plus arranged in year	-41.1	
at 31st March 2011	13.1	3.13
Average Borrowing	**13.0**	**3.07**

3.2 As the Council's reserves have fallen over the last few years the number of fund managers have reduced leaving just CDCM at the start of the year with £5M. They had also been given notice in March 2009 and as investments reached their maturity all funds were managed in-house. At the end of September the fund was closed when the last investment reached maturity. In-house investments started the year at £15M and were £15.5M at the end of the year. The table below shows the returns by fund manager. Whilst the benchmark for in-house funds is officially the 7 day rate, a split has also been shown to indicate a comparison for the medium term element against the 3 month rate as used for CDCM:

PERFORMANCE FOR THE YEAR APRIL 2010 – MARCH 2011				
	Average Investment £M	Performance %	Benchmark %	Variation from benchmark %
CDCM	**3.9**	**5.1**	**0.6****	**+4.5**
In-house	**24.4**	**2.7**	**0.4^^**	**+2.3**
medium term	10.0	4.4	0.6**	+3.8
short-term for cash flow	14.4	1.5	0.4^^	+1.1

** 3 month LIBID ^^ 7 day rate

3.3 This very good performance was due to many of the investments being locked into higher rates before the year started together with the use of liquidity accounts with major banks and building societies which gave added safety from instant access together with interest rates comfortably in excess of the benchmark.

3.4 The actual net investment interest (after deduction of interest payable on loans) was £337k compared with a budget of £207k due to the higher than estimated interest rates and higher levels of reserves.

4. STRATEGY – BORROWING

4.1 Long-term borrowing. The strategy allowed for ‘must borrow’ to finance that part of the capital programme that could not be met from internal funds. There was also a provision for ‘may borrow’ which allowed borrowing in anticipation of need, based on whether longer term rates seemed low compared with future likely levels. No long-term borrowing was carried out as the rates were not deemed to be low enough and there were sufficient internal funds to finance the capital spending in the year.

4.2 Short-term borrowing. The Authority needed to borrow short-term during the year to manage its cash flow; it averaged £3.0m

5. STRATEGY - INVESTMENTS

5.1 The Council’s strategy for 2010/11 was based on using CDCM managing a reducing value of time deposits with the remainder managed in-house.

5.2 The in-house investments could be of two types: time deposits and liquidity (call) accounts with banks with a high credit rating and the top 25 building societies by asset value. The strategy included limits on the size of investments with each organisation and country limits. The mandates for CDCM and in-house funds are shown in Annex B

5.3 The strategy was reviewed during the course of the year with the Treasury Management Advisory Group due to the merger of a number of building societies and concerns about the financial stability of some European countries where the Authority had previously placed funds, for example Ireland.

5.4 The review concluded that the Authority should continue to invest in banks and building societies based on the approved strategy, but if the Council borrowed in anticipation of need leading to a temporary increase in funds to be invested, the policy should be reviewed

6. RISK MANAGEMENT

6.1 The Council’s primary objectives for the management of its investments are to give priority to the security and liquidity of its funds before seeking the best rate of return.

6.2 **Security** is managed by investing short-term with highly-rated banks, building societies and local authorities in the UK. The Authority receives regular updates from its advisors, Sterling Consultancy Services, sometimes daily, on changes to the credit rating of counterparties. This allows the Council to amend its counterparty list and not invest where there is concern about the credit rating.

6.3 **Liquidity.** The majority of the funds are time deposits which cannot be traded and this means that they will not be returned until the end of the agreed period. However the Council has also made use of liquidity accounts which have a rate or interest above base rate and provide instant access to funds. The interest rate on credit balances at the bank has been generous and so the account has been kept in credit, providing additional liquidity.

6.4 Overall, liquidity is managed by producing cash flow forecasts that help set the limit on the duration of the investments in time deposits. The projections tended to be cautious which sometimes resulted in funds being available before they were needed with any surplus easily being invested on a temporary basis.

6.5 **Return on investments.** Security and liquidity take precedence over the return on investments, which has resulted in investments during 2010/11 generally being of short duration at lower rates of interest.

6.6 The risk was mitigated in two ways. When the Authority borrowed £10M in advance in December 2008 it invested the funds in the meantime, at marginally higher interest rates thus protecting the Council from any short term loss of interest. Secondly, the use of the above-market rates on credit balances in the bank account (until bank charges have been covered) and liquidity accounts have given attractive returns at low risk.

7. COMPLIANCE WITH REGULATIONS AND CODES

7.1 All the treasury management activity undertaken during the financial year complied with the approved strategy, the CIPFA Code of Practice, and the relevant legislation

7.2 The Code requires the Council to approve Treasury Management and Prudential Indicators. Those for 2010/11 were approved at the Council meeting on 17th February 2010. Annex C shows the relevant indicators and the actual results.

8. PARISH AND TOWN COUNCILS

8.1 The Council was made aware of the difficulty of some Parish and Town Councils in achieving any returns on their cash deposits and in January 2010 introduced a scheme whereby Parish and Town Councils could invest funds with this Council. Once received they simply form part of the Council's investment portfolio. The terms of the scheme are shown in Annex D.

8.2 To date only one investment has been received of £100k from Brampton Parish Council

9 CONCLUSION

9.1 The performance of the funds in a year when rates stayed very low was pleasing, significantly exceeding both the benchmark and the budgeted investment interest.

9.2 In a year of uncertainty in the financial markets all of the Council's investments were repaid in full and on time.

9.3 The Authority has carried out its treasury management activities with due regard to minimising risk, and in accordance with legislation. During the year it reviewed its strategy in the light of external events in the markets.

10 RECOMMENDATION

10.1 It is recommended that Cabinet note this report.

BACKGROUND INFORMATION
2010/1 cash management files and working papers
Reports to the Cabinet and Treasury Management Advisory Group
CIPFA Code on Treasury Management

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ANNEX A

BORROWING AND INVESTMENTS AT 31 MARCH 2011

	RATING		DATE INVESTED/ BORROWED	AMOUNT £M	£M	INTEREST RATE %	REPAYMENT DATE	YEAR OF MATURITY
BORROWING								
Short term								
Coventry Building Society			22-Mar-11	-3.0		0.620	15-Apr-11	2011/12
Brampton Parish Council			01-Mar-10	-0.1		0.500		
					- 3.1			
Long term								
PWLB			19-Dec-08	- 5.0		3.910	19-Dec-57	2057/58
PWLB			19-Dec-08	- 5.0		3.900	19-Dec-58	2058/59
					-10.0			
TOTAL BORROWING					**- 13.1**			
INVESTMENTS								
IN-HOUSE								
Short term								
Natwest Liquidity AC	F1+	P1		0.5		0.800		2011/12
Bank of Scotland	F1+	P1	11-Mar-11	5.0		1.930	08-Feb-12	2011/12
					5.5			
Medium term								
Royal Bank of Scotland	F1+	P1	19-Dec-08	5.0		4.040	19-Dec-12	2012/13
Skipton BS	F2	P2	19-Dec-08	5.0		4.850	19-Dec-13	2013/14
					10.0			
TOTAL - INVESTMENTS					**15.5**			
NET INVESTMENTS					**2.4**			

ANNEX B

IN-HOUSE FUND MANAGEMENT 2010/11
(IF NO FURTHER BORROWING IN ANTICIPATION)

Duration of investments	No investment shall be longer than 5 years.
Types of investments	Fixed term Deposits Deposits at call, two or seven day notice Corporate bonds
Credit Ratings	Short term rating F1 by Fitch or equivalent Long-term rating of AA- by Fitch or equivalent if the investment is longer than 1 year (excluding Building Societies)
Maximum limits per counterparty (group), country or non-specified category	F1+ or have a legal position that guarantees repayment for the period of the investment — £5M F1 — £4M Building Society with assets over £2bn in top 25 (Currently 13) — £5M Building Society with assets over £1bn if in top 25 (Currently 3) — £4M Building Society with assets under £1bn in top 25 — £3M Liquidity (Call) Account with a credit rating of F1+ or with a legal position that guarantees repayment. — £5M BUT total invest with counterparty/group shall not exceed — £8M **Limit for Non-specified investments** – £10M in time deposits more than one year – £5M in corporate bonds – £10M in total **Country limits** -----UK Unlimited – £6M in a country outside the EU – £10M in a country within the EU (excluding UK) – £20M in EU countries combined (excluding UK) These limits will be applied when considering any new investment from 17 February 2010. Lower limits may be set during the course of the year or for later years to avoid too high a proportion of the Council's funds being with any one counterparty.
Benchmark	LGC 7 day rate

Annex C

Prudential Indicators for 2010/11 relating to Treasury Management
Comparison of actual results with limits

EXTERNAL DEBT

The authorised limit for external debt.
This is the maximum limit for borrowing and is based on a worst-case scenario. This limit, and the operational boundary below, were set to allow up to £36.5m of borrowing in anticipation of need.

2010/11 Limit £000	**2010/11 Actual £000**
60,100	**19,300**

The operational boundary for external debt.
This reflects a less extreme position. Although the figure can be exceeded without further approval it represents an early warning monitoring device to ensure that the authorised limit (above) is not exceeded.

2010/11 Limit £000	**2010/11 Actual £000**
55,100	**19,300**

Both of these actual results reflect the fact that long term rates were not considered low enough to borrow in anticipation of need

TREASURY MANAGEMENT

Exposure to investments with fixed interest and variable interest.
These limits are given as a percentage of total investments.

	2010/11 Limit	**2010/11 Actual**
Upper limit on fixed rate exposure	100%	**100%**
Upper limit on variable rate exposure	50%	**0%**

The Council had no variable rate investments in the year

Borrowing Repayment Profile
The proportion of 2010/11 borrowing that matured in successive periods.

Cash flow borrowing	Upper limit	**Actual**	Lower limit
Under 12 months	100%	**100%**	100%
12 months and within 24 months	0%	0%	0%
24 months and within 5 years	0%	0%	0%
5 years and within 10 years	0%	0%	0%
10 years and above	0%	0%	0%

Funding capital schemes	Upper limit	**Actual**	Lower limit
Under 12 months	25%	0%	0%
12 months and within 24 months	25%	0%	0%
24 months and within 5 years	25%	0%	0%
5 years and within 10 years	50%	0%	0%
10 years and above	100%	**100%**	0%

Investment Repayment Profile
Limit on the value of investments that cannot be redeemed within 364 days.

2010/11 Limit £000	**2010/11 Actual - maximum in year £000**	**2010/11 Actual as at 31/3/11 £000**
36,000	**10,000**	**10,000**

Annex D

DEPOSIT OF PARISH AND TOWN COUNCIL FUNDS WITH HUNTINGDONSHIRE DISTRICT COUNCIL

The terms of the scheme

Minimum sum
£25,000.

Period
Either a fixed term of not less than 3 months
OR
A minimum of 3 months with a minimum of 30 days notice for repayment after 3 months

Rate
Prevailing Bank Base Rate during the period of the investment

Payment of Interest
Paid annually on 31 March or on repayment whichever is the earliest

Transmission
Funds must be received electronically and repaid in same way

Agreement
The Parish or Town Council will be sent an email confirming receipt of the deposit and confirming the terms.

Changes to these terms
The District Council reserves the right to vary or cancel this offer but this will not affect any investment already completed.