

Annual Treasury Outturn Report 2010/11

1 Purpose

- 1.1 The County Council adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice, which includes an annual report on the treasury management strategy after the end of each financial year.

2 Summary

- 2.1 Treasury management in the context of this report is defined as:

“The management of the organisation’s investments and 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.”

- 2.2 This annual report sets out the performance of the treasury management function during 2010/11, to include the effects of the decisions taken and the transactions executed in the past year.
- 2.3 Overall responsibility for treasury management remains with the County Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the County Council’s treasury management objectives.
- 2.4 All treasury activity has complied with the County Council’s Treasury Management Strategy Statement and Investment Strategy for 2010/11, and all relevant statute, guidance and accounting standards.
- 2.5 The prudential and treasury management indicators which are all covered in this report are:
- actual capital financing requirement
 - actual external debt
 - authorised limit and operational boundary for external debt
 - upper limits for fixed interest rate exposure and variable interest rate exposure
 - maturity structure of fixed rate borrowing
 - total principal sums invested for periods longer than 364 days
 - ratio of financing costs to net revenue stream.

- 2.6 A major change in treasury management in 2010/11 was the County Council's appointment of Arlingclose as advisers in December 2010.

3 Economic background

- 3.1 At the time of determining the strategy for 2010/11, interest rates were expected to remain low in response to the fragile state of the UK economy.
- 3.2 The economy's two headline indicators moved in opposite directions – growth was lacklustre whilst inflation spiked sharply higher. The economy grew by just 1.3% in the calendar year 2010; the forecast for 2011 was revised down to 1.7% by the Office of Budget Responsibility in March 2011. Higher commodity, energy and food prices and the increase in VAT to 20% pushed the February 2011 annual inflation figure to 4.4%. The Bank of England base rate was held at 0.5% as the economy grappled with uneven growth and the austerity measures set out in the coalition government's Comprehensive Spending Review.
- 3.3 The US Federal Reserve kept rates on hold at 0.25% following a slowdown in American growth. The European Central Bank maintained rates at 1%, with the markets expecting a rate rise in early Spring 2011.
- 3.4 The ratings of Ireland and Portugal were downgraded to the BBB category whilst the rating of Greece was downgraded to sub-investment (or 'junk') grade. The sovereign rating of Spain was also downgraded but remained in the AA category. The results from the EU Bank Stress Tests highlighted that only 7 out of the 91 institutions failed the 'adverse scenario' tests. The tests were a helpful step forward, but there were doubts if they were far-reaching or demanding enough. The main UK banks' (Barclays, HSBC, Lloyds and RBS) Tier 1 ratios all remained above 9% under the stress tests.
- 3.5 During the year, money market rates increased marginally at the shorter end (overnight to 3 months). Rates for 6 to 12 months increased between 0.25% to 0.30% over the 12 month period reflecting the expectation that the base rate would be raised later in 2011.

4 The borrowing requirement and debt management

	Balance on 31/03/2010 £m	Net new borrowing £m	Balance on 31/03/2011 £m
Capital Financing Requirement	714.9		747.6
Long Term Borrowing	336.6	29.3	365.9
Temporary borrowing	105.3	-66.5	38.8
Total Borrowing	441.9	-37.2	404.7
Other Long Term Liabilities	85.5	9.0	94.5
Total External Debt	527.4	-28.2	499.2

- 4.1 Capital expenditure for the year was £196.3m, £1.5m less than estimated at £197.8m. £64.4m of that capital expenditure was financed by borrowing and from other long term liabilities and repayments of £31.7m were made, resulting in an increase in the capital financing requirement of £32.7m, as reflected in the table above.
- 4.2 On 20 October 2010, the Comprehensive Spending Review (CSR) increased the cost of new local authority fixed rate loans to 1% above the cost of the Government's borrowing. Premature repayment rates did not benefit from the increase in the margin which potentially makes future rescheduling of PWLB loans more challenging.
- 4.3 The County Council funded £36m of its capital expenditure through new borrowing from the PWLB. The PWLB remained the County Council's preferred source of borrowing, given the transparency and control that its facilities continue to provide.

Loans borrowed during 2010/11	Principal £m	Average rate %	Average Maturity (years)
PWLB Fixed Rate Maturity Loans	16.0	4.44	23.7
PWLB Fixed Rate Equal Instalment of Principal (EIP) Loans	20.0	3.62	4.7

- 4.4 Whilst the County Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31 March 2011 is £747.6m, a cautious approach has been applied in terms of take-up of new borrowing to minimise debt interest payments without compromising the long-term stability of the portfolio. Internal resources in lieu of external borrowing have been used to a significant extent in order to lower overall treasury risk by reducing both external debt and temporary investments.

Actual external debt

- 4.5 Actual external debt at 31 March 2011 was £499.2m. Total external borrowing reduced by £28.2m during 2010/11.

5 Investment activity

- 5.1 The County Council has invested according to a low risk, high quality lending list as outlined in the Investment Strategy for 2010/11.

	Balance on 31/03/2010 £m	Balance on 31/03/2011 £m	Average Rate at 31/3/11 / Average Life
Instant access monies	38.1	33.6	1.10% / 0.0 yrs
Short term investments	148.5	171.2	1.63% / 0.9 yrs
Long term investments	-	10.00	1.80% / 1.2 yrs
Total investments	184.6	214.8	1.38% / 0.5 yrs

5.2 Security of capital remained the County Council's main investment objective. This was maintained by following the County Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2010/11. Investments during the year included:

- Deposits in AAA-rated Money Market Funds
- Call accounts and deposits with banks and building societies systemically important to the UK's banking system.

5.3 Credit risk was assessed and monitored by the County Treasurer and the County Council's external treasury advisers, Arlingclose, with reference to:

- Credit ratings (minimum long-term A+ for counterparties; AA+ for countries), using all three Government recognised credit rating agencies
- Credit default swaps
- Net debt as a percentage of GDP
- Sovereign support mechanisms/potential support from a well-resourced parent institution
- Share prices
- Macro-economic indicators
- Corporate developments, news and articles, market sentiment.

5.4 The County Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK base rate was maintained at 0.5% through the year. Short term money market rates remained at very low levels which had a significant impact on cash investment income:

Date	Base Rate	O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid
01/04/2010	0.50	0.35	0.35	0.42	0.51	0.81	1.26	1.54
30/04/2010	0.50	0.30	0.30	0.43	0.53	0.83	1.29	1.70
31/05/2010	0.50	0.45	0.50	0.61	0.60	0.85	1.35	1.46
30/06/2010	0.50	0.35	0.35	0.45	0.61	0.94	1.38	1.40
31/07/2010	0.50	0.40	0.40	0.50	0.71	1.01	1.46	1.36
31/08/2010	0.50	0.40	0.55	0.50	0.71	1.00	1.45	1.20
30/09/2010	0.50	0.30	0.25	0.51	0.72	1.01	1.46	1.24
31/10/2010	0.50	0.48	0.40	0.51	0.72	1.01	1.46	1.26
30/11/2010	0.50	0.40	0.51	0.51	0.72	0.88	1.46	1.32

Date	Base Rate	O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid
31/12/2010	0.50	0.40	0.40	0.51	0.72	1.01	1.47	1.49
31/01/2011	0.50	0.40	0.55	0.52	0.64	1.04	1.52	1.74
28/02/2011	0.50	0.40	0.54	0.53	0.68	1.09	1.56	1.85
31/03/2011	0.50	0.30	0.50	0.54	0.80	1.11	1.58	1.85
Minimum	0.50	0.30	0.25	0.42	0.51	0.75	1.00	1.13
Average	0.50	0.39	0.43	0.50	0.67	0.98	1.44	1.50
Maximum	0.50	0.55	0.55	0.80	0.80	1.11	1.58	1.97
Spread		0.25	0.30	0.38	0.29	0.36	0.58	0.84

- 5.5 The County Council's average cash investment balance was £297m during 2010/11, and interest earned was £3,169,000, leading to an average yield of 1.1%.

Compliance with Prudential Indicators

- 5.6 The County Council can confirm that it has complied with its Prudential Indicators for 2010/11, which were set in February 2010 as part of the County Council's Treasury Management Strategy Statement.
- 5.7 In compliance with the requirements of the CIPFA Code of Practice, this report provides Members with a summary report of the treasury management activity during 2010/11. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.

Capital Financing Requirement

- 5.8 The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR) together with the availability of internal resources to temporarily defray borrowing are core drivers of Treasury Management Activity. The estimates, based on the approved Revenue Budget and Capital Programmes, and actual position as at 31 March 2011 are:

	31/03/2011 Estimate £m	31/03/2011 Actual £m
Total Capital Financing Requirement	755.2	747.6
Less:		
Existing profile of long term borrowing	-356.0	-365.9
Other long term liabilities	-96.5	-94.5
Temporary borrowing	-20.0	-38.8
Cumulative additional maximum external borrowing requirement	282.7	248.4
Less:		
Reserves, balances and other internal resources	-399.2	-463.2
Funds for investment temporarily available at 31 March 2011	-116.5	-214.8

Authorised limit and operational boundary for external debt

- 5.9 CIPFA's Code of Practice requires authorities to set an authorised limit for external debt, defined as the sum of external borrowing and other long-term liabilities. This is a statutory limit which should not be breached. The County Council's authorised limit was set at £780m for 2010/11.
- 5.10 This limit is based on the estimated Capital Financing Requirement (CFR) in order to enable it to be financed entirely from external borrowing should the County Council's internal reserves become depleted. The limit also includes an allowance for temporary borrowing to cover normal revenue cash flow requirements and unexpected outflows or delays in receiving cash.
- 5.11 During 2010/11, the gross borrowing reached a maximum of £573m which is within the authorised limit of £780m.
- 5.12 The County Council also needs to set an operational boundary for external debt. This should reflect the most likely scenario and be consistent with the County Council's capital plans and Treasury Management Strategy. Temporary breaches of the 2010/11 operational boundary can take place for cash flow reasons, but any sustained breach will lead to further investigation. The County Council approved an operational boundary for 2010/11 of £660m.

- 5.13 During 2010/11, the gross borrowing reached a maximum of £573m which is within the operational boundary of £660m.

Upper limits for fixed interest rate exposure and variable interest rate exposure

- 5.14 These indicators allow the County Council to manage the extent to which it is exposed to changes in interest rates.
- 5.15 The County Council has to set an upper limit on its fixed interest rate exposure, which is expressed in terms of the maximum long-term fixed-rate principal sums which can be outstanding on any day in each year. The County Council approved an upper limit on fixed interest rate exposure for 2010/11 of £420m.
- 5.16 During 2010/11, the long-term fixed-rate principal sums outstanding reached a maximum of £405m which is within the upper limit on fixed interest rate exposure of £420m.
- 5.17 The County Council also has to set an upper limit on its variable interest rate exposure. This is calculated simply as the difference between the approved authorised borrowing limit and the fixed-rate borrowing outstanding at the end of each year if no further such borrowing is undertaken. The County Council approved an upper limit on variable interest rate exposure for 2010/11 of £420m.
- 5.18 During 2010/11, the variable interest rate exposure reached a maximum of £198m which is within the upper limit on variable interest rate exposure of £420m.

Maturity structure of fixed rate borrowing

- 5.19 The Code also requires the County Council to set upper and lower percentage limits on the maturity structure of its long-term fixed rate borrowing during 2010/11. The following table shows the limits approved by the County Council. These have been set in order to allow maximum flexibility in managing the debt portfolio and are consistent with the existing portfolio.

	Upper limit (%)	Lower limit (%)	Actual (%)
Under 12 months	10	0	2
12 to 24 months	10	0	2
24 months to 5 years	20	0	10
5 years to 10 years	30	10	15
10 years and beyond	90	70	71

- 5.20 The County Council's long-term fixed rate borrowing during 2010/11 has not breached these set limits.

Total principal sums invested for periods longer than 364 days

- 5.21 For 2010/11, the County Council originally set an upper limit of nil on investments for periods longer than one year in February 2010. On setting the Treasury Management Strategy Statement for 2011/12 in February 2011, the opportunity was taken to revise the upper limit for 2010/11 to £10m.
- 5.22 This indicator allows the Authority to manage the risk inherent in investments longer than 364 days.
- 5.23 In March 2011, a 15-month fixed term deposit for £10m was placed with another local authority at an associated interest rate of 1.80%. This long term investment is fully compliant with the revised £10m upper limit for 2010/11.

Ratio of financing costs to net revenue stream

- 5.24 The ratio of financing costs to the net revenue stream shows the estimated annual revenue costs of borrowing (interest payable on debt plus the minimum revenue provision for repaying the principal less interest on balances) as a percentage of the amount in the draft revenue budget to be met from central government grant and by local taxpayers. Actual figures for 2009/10 and 2010/11 together with the estimate for 2010/11 are set out in the table below.

	2009/10 Actual £m	2010/11 Estimate £m	2010/11 Actual £m
Financing costs	43.8	51.8	50.0
Net revenue stream	657.0	672.1	672.1
Ratio	6.67%	7.71%	7.44%

- 5.25 Lower financing costs in 2010/11 than estimated reflect the underspending reported in the 2010/11 outturn report.