| REPORT TO | DATE OF MEETING |
|---|---|
| GOVERNANCE COMMITTEE | 28 JUNE 2011 |

Report template revised June 2008

SOUTH RIBBLE BOROUGH COUNCIL

forward with South Ribble

| SUBJECT | PORTFOLIO | AUTHOR | ITEM |
|---|---|---|---|
| TREASURY MANAGEMENT ANNUAL REPORT 2010/11 | FINANCE AND RESOURCES | G WHITEHEAD | |

## SUMMARY AND LINK TO CORPORATE PRIORITIES

1. The report advises that Prudential and Treasury Indicators were complied with and that the return on investments totalled 1.13% which exceeded the benchmark. Details of borrowings are given and the situation with regard to the Icelandic investments is updated. A review of the economy and interest rates is also provided.

   It links to the Council's corporate priorities in the delivery of excellent services.

## RECOMMENDATIONS

1. Members are asked to note the report

## DETAILS AND REASONING

**1. Prudential Indicator: Capital Expenditure and Financing 2010/11**

A comprehensive report on capital out-turn is separately submitted on this agenda. The key issue as far as treasury operations are concerned, is that capital expenditure is approximately £2m less than that envisaged when the Treasury Strategy was originally reported.

**2. Prudential Indicator: The Capital Financing Requirement (CFR)**

The CFR is a measure of the capital expenditure of the Council which is still to be paid for. Such expenditure will currently be met by borrowing or by temporarily using internal cash balances. Ultimately however it has to be paid for and will be a charge to Council tax payers.

| | Original Estimate £000 | Actual £000 |
|---|---|---|
| Capital Financing Requirement at 1 April 2010 | 5,025 | 5,064 |
| Change in year – prudential borrowing and leasing | 3,407 | 1,398 |
| - MRP | (267) | (268) |
| - Voluntary MRP | (276) | (276) |
| **CFR at 31 March 2011** | **7,889** | **5,918** |

It will be seen that the CFR has reduced as a result of the reduction in capital expenditure.

3. **Prudential Indicator The CFR and Borrowing**
   The Prudential Code requires that borrowing, net of investments, should be compared to the CFR, and should not exceed the current years CFR plus the anticipated increase in the next two years. As at 31 March 2011 the Council has no borrowings. This requirement is therefore met.

4. **Compliance with Borrowing Limits**
   The Prudential Indicators include two borrowing limits. The Operational Boundary is the expected borrowing position. This was set at £7.5m and has not been exceeded. The Authorised Limit is the limit, set by the Council itself, required by Section 3 of the Local Government Act 2003. The Council does not have power to exceed it. This was set at £7.889m and has not been exceeded.

5. **Prudential Indicator Ratio of Financing Costs to the Revenue Stream**
   This indicator shows what percentage of the Council's income from Government grants and council tax has been used to meet interest costs and debt repayment. This has increased from 2.04% to an out-turn figure 2.5% as a result of the impairment provision (see paragraph 16).

6. **Prudential Indicator Incremental impact of capital investment decisions**
   This indicator seeks to assess the impact on Council Tax payers of changes in the capital programme. The original estimated impact on Band D charges was £1.05 pa. This has reduced to £0.87. This has been brought about by financing the bins from Capital Receipts and re-programming some capital schemes into 2011/12.

7. **Treasury Position as at 31 March 2011**

| | **Estimated value as at 31 March 2011 £000** | **Actual value as at 31 March 2011 £000** |
|---|---|---|
| Borrowing at period start | 472 | 472 |
| Borrowing repaid in year | (472) | (472) |
| Borrowing in year | 0 | 0 |
| **Total borrowing at period end** | **0** | **0** |
| | | |
| **Investments excluding Iceland deposit** | **5,800** | **9,234** |

8. **Borrowings**
   The Half Yearly Review, considered by members in November, advised that cash balances were considered adequate to avoid the need for further borrowing over the next two or three years. Had borrowing been taken, even with the very low PWLB rates on offer, there would have been a carrying cost. Furthermore the Comprehensive Spending Review announced that, with immediate effect, the margins added by the PWLB when fixing rates would be increased to damp down borrowing demand. The Council has therefore no external borrowings.

## 9. Treasury Indicator Upper limit on fixed rate exposure

The Council is exposed to fixed interest rates on its long term liabilities (leased assets and deferred purchase acquisitions). The indicator for 2010/11 was £7.5m and has not been breached.

## 10. Investments

There has been a significant increase in the value of investments. It was anticipated that these would have totalled around £5.8m to nil by year end, but in fact they totalled £9.23m. The principal reasons for this are as follows:

- There has been a reduction of £2m in debtors net of creditors. The largest reduction is in the balance owing by the DCLG in respect of NNDR (fall of £1.6m).
- There has been a surplus of £0.7m on the I&E account during the year
- Capital grants and contributions balances have increased by £0.5m

The reduced capital expenditure has had no effect since it is offset by a reduction in the external lease financing.

**The following table summarises investment activity and returns in 2010/11:-**

| Details | Average daily Investment £000 | Interest Earned £000 | Average Rate % |
|---|---|---|---|
| The Council's own bank | 1,020 | 0 | 0 |
| Short Term deposits | 5,408 | 110 | 2.03 |
| Call accounts | 7,369 | 50 | 0.68 |
| Debt Management Office (DMO) | 388 | 1 | 0.25 |
| **Total** | **14,185** | **161** | **1.13** |

The performance benchmark is the London 7 day Inter-Bank Bid Rate (LIBID). This averaged 0.43% over the year.
All investments complied with the limits set in the Treasury Strategy as updated during the year.

**The performance against budget for the year is as follows:-**

| | Original Budget £000 | Actual £000 |
|---|---|---|
| Interest payable on borrowings | 17 | 17 |
| Leased assets | 140 | 140 |
| Impairment of investments | 0 | 58 |
| Interest earned:- | | |
| On current investments | (173) | (161) |
| On Icelandic investments | (220) | (206) |
| **Net** | **(236)** | **(152)** |

**11. Treasury Indicator Upper limit on exposure to variable interest rates**

The Council is exposed to variable interest rates only on its invested cash. A limit of 100% was set, i.e. it assumed and allowed all surplus cash to be invested at variable rates.

**12. Icelandic Investments**

In April the long awaited judgement of the Icelandic courts was delivered, upholding the priority status of Local Authority deposits in Landsbanki. This is still subject to further challenge in the Icelandic Supreme Court, and repayments are frozen until this is resolved (expected late autumn). 95% recovery is assumed, but the repayment period has been extended to 2018. This has necessitated an additional impairment charge of £146k. Repayment of the Heritable deposits has continued to be made at quarterly intervals. The recoverable amount has been reassessed as 85% (compared to 80% previously assumed), and the repayment period shortened by nine months to September 2012. This has reduced the impairment provision by £88k.

The book value of the Council's investment at 31/3/2011 was £3.149m. This was after the following in year transactions.

| | Heritable £000 | Landsbanki £000 | Total £000 |
|---|---|---|---|
| Balance as at 1 April 2010 | 845 | 2,461 | 3,306 |
| Interest accrued during the year | 47 | 159 | 206 |
| Additional impairment | 88 | (146) | (58) |
| Repayment | (305) | | (305) |
| **Total** | **675** | **2,474** | **3,149** |

**13. The economy and Interest rates**

The review of the year provided by the Council's consultant is at Appendix A.

**14. Treasury Advisors**

2010/11 was the first of the three years covered by the contract with Sector Treasury Services. The significant event in the year was the merger between Sector and its biggest competitor, Butlers.

**WIDER IMPLICATIONS**

In the preparation of this report, consideration has been given to the impact of its proposals in all the areas listed below, and the table shows any implications in respect of each of these. The risk assessment which has been carried out forms part of the background papers to the report.

| | |
|---|---|
| ***FINANCIAL*** | As set out in the report and its appendices. |
| ***LEGAL*** | Compliance with various Regulations and Statutory Codes of Practice. |
| ***RISK*** | The Council's treasury management strategy and policies are designed to ensure the effective control and management of the risks associated with such activities. |
| ***OTHER (see below)*** | |

| | | | |
|---|---|---|---|
| *Asset Management* | *Corporate Plans and Policies* | *Crime and Disorder* | *Efficiency Savings/Value for Money* |
| *Equality, Diversity and Community Cohesion* | *Freedom of Information/ Data Protection* | *Health and Safety* | *Health Inequalities* |
| *Human Rights Act 1998* | *Implementing Electronic Government* | *Staffing, Training and Development* | *Sustainability* |

**BACKGROUND DOCUMENTS**

| | |
|---|---|
| Treasury Management Strategy | 02/03/2010 |
| Treasury monitoring report | 12/08/2010 |
| Treasury mid year review | 11/11/2010 |

# 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.