Committee and Date	Item
SMB 05 September 2011 Cabinet 14 September 2011 Audit Committee 20 September 2011 Council 22 September 2011	**9** Public

ANNUAL TREASURY REPORT 2010/11

Responsible Officer Justin Bridges
e-mail: Justin.bridges@shropshire.gov.uk Tel: (01743) 252072 Fax (01743) 252184

1. Summary

1.1. The report informs members of treasury activities for Shropshire Council for 2010/11, including the investment performance of the internal treasury team to 31 March 2011. The internal treasury team outperformed their investment benchmark by 0.41% in 2010/11, performance for the last three years is 0.57% above benchmark. Treasury activities during the year have been within approved prudential and treasury indicators set and have complied with the Treasury Strategy.

1.2. During 2010/11 there was an under spend of £1.485 million compared to budget as highlighted in paragraph 10.5 of this report. This under spend was used to fund mainly, budget corrections and voluntary severance costs.

1.3. Members will be aware that Bridgnorth District Council had £1 million invested in the Icelandic Bank, Landsbanki Islands. The latest position in relation to this investment is that Shropshire Council could receive 95% back of the principal sum invested however payments are likely to be delayed until December 2011 with annual payments thereafter and the final payment being made in December 2018.

2. Recommendations

2.1. Members are asked to accept the position as set out in the report.

REPORT

3. Risk Assessment and Opportunities Appraisal

3.1. The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998.

3.2. There are no direct environmental, equalities or climate change consequences arising from this report.

3.3. Compliance with the CIPFA Code of Practice on Treasury Management, the Council's Treasury Policy Statement and Treasury Management Practices and the Prudential Code for Capital Finance together with the rigorous internal controls will enable the Council to manage the risk associated with Treasury Management activities and the potential for financial loss.

4. Financial Implications

4.1. There are no direct financial implications arising from this report.

5. Background

5.1. The Council defines its treasury management activities as "the management of the authority'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".

5.2. The Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2010/11. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

5.3. Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. Minimum reporting requirements are that the Council should receive the following reports:

- An annual treasury strategy in advance of the year.
- A mid year treasury update report.
- An annual report following the year describing the activity compared to the strategy.

5.4. The CIPFA Code of Practice on Treasury Management states that these reports should be scrutinised by a nominated committee and that members should be trained on treasury management activities in order to support them in their scrutiny role. These reports were scrutinised by the Audit Committee before they were reported to full Council for approval. Members also received training on treasury management issues during the year.

5.5. In addition to the minimum reporting requirements, the Strategic Management Board and Cabinet also receive quarterly treasury management update reports for information.

5.6. The Treasury Strategy for 2010/11 was approved by Council in February 2010, the mid year treasury update report was approved by Council in

December 2010. This Annual Report sets out our actual treasury performance for the year and shows, in much the same way as we do for the budget, how the actual treasury performance varied from our estimates and planning assumptions.

6. **Borrowing Strategy for 2010/11**

6.1. The borrowing strategy for the year continued to be funding the Council's long term borrowing requirement at advantageous rates. Short term finance from internal balances would be used in the interim pending favourable market conditions for long term funding.

6.2. Short term Public Works Loan Board (PWLB) rates were expected to be significantly cheaper than longer term borrowing rates during the year therefore borrowing in the 10 year period early on in the financial year when rates were expected to be at their lowest would be considered. Variable rate borrowing was also expected to be cheaper than long term fixed rate borrowing throughout the year.

6.3. An alternative strategy was to defer any new borrowing as long term borrowing rates were expected to be higher than investment rates during the year. This would maximise savings in the short term and also have the added benefit of running down investments which would reduce credit risk during the continued market turmoil. Short term money market borrowing was not used during the year.

7. **Borrowing outturn for 2010/11**

7.1. The Treasury Team take advice from its external treasury advisor, Sector Treasury Services, on the most opportune time to borrow. Movements in rates during 2010/11 are shown in the graph at Appendix A.

7.2. There was an unexpected change of policy on PWLB lending arrangements in October 2010 following the Comprehensive Spending Review. This resulted in an increase in all new borrowing rates of between 0.75 – 0.85%, without an associated increase in early redemption rates. This made new borrowing more expensive and repayment relatively less attractive.

7.3. The table below shows PWLB borrowing rates for a selection of maturity periods. The table also shows the high and low points in rates during the year, average rates during the year and individual rates at the start and the end of the financial year.

	4.5 – 5yrs	**9.5 – 10yrs**	**24.5 – 25 yrs**	**49.5 – 50 yrs**
01/04/2010	2.84%	4.14%	4.62%	4.65%
31/03/2011	3.57%	4.71%	5.32%	5.25%
High	3.83%	4.99%	5.56%	5.48%
Low	1.82%	3.06%	3.92%	3.93%
Average	2.79%	4.05%	4.77%	4.76%
High date	09/02/2011	09/02/2011	09/02/2011	09/02/2011
Low date	12/10/2010	31/08/2010	31/08/2010	31/08/2010

7.4. Following discussions with Sector, as borrowing rates were significantly higher than investment rates during the year it was agreed that borrowing would be deferred in order to maximise savings in the short term and reduce credit risk by reducing investments.

7.5. The Council's debt portfolio at 31 March 2011 is set out below:-

Type of Debt	Balance £m	Average Borrowing Rate 2010/2011
Fixed rate – PWLB	228.7	5.5%
Fixed rate – Market	49.2	4.1%
Variable rate	0	N/A

7.6. The average borrowing rate for the total portfolio (PWLB and Market) has reduced from 5.44% in 2009/10 to 5.41% in 2010/11 due to loans at higher interest rates maturing during the year and being repaid. The maturity profile of the debt is evenly spread to avoid large repayments in any one financial year. The average debt period for PWLB loans is 20 years, market loans have an average debt period of 58 years. The total debt portfolio has a maturity range from 1 year to 67 years.

7.7. The Treasury Strategy allows up to 15% of the total outstanding debt to mature in any one year. It is prudent to have the Council's debt maturing over many years so as to minimise the risk of having to re-finance when interest rates may be high. The actual debt maturity profile is within these limits (Appendix B).

8. Debt rescheduling

8.1. No debt restructuring was undertaken during 2010/11. The introduction of a differential in PWLB rates on the 1 November 2007, which was compounded further since a policy change in October 2010 as outlined above, has meant that large premiums would be incurred if debt restructuring was undertaken which cannot be justified on value for money grounds.

8.2. Although these changes have restricted debt restructuring, the current debt portfolio is continually monitored in conjunction with external advisers in the light of changing economic and market conditions in order to identify opportunities for debt rescheduling. Debt rescheduling will only be undertaken:

- To generate cash savings at minimum risk.
- To help fulfil the Treasury Strategy.
    - To enhance the balance of the long term portfolio by amending the maturity profile and/or volatility of the portfolio.

9. Investment Strategy for 2010/11

9.1. Our treasury advisor originally felt when the strategy was approved by Council in February 2010 that the bank rate would rise from 0.50% to 0.75% in September 2010 before rising again in December 2010 and March 2011 to reach 1.50% by the end of the financial year. During the year their interest rate forecast was reviewed and their updated forecast was approved by Council in December 2010 as part of the mid year report. Their revised forecast was that the bank rate would remain at 0.50% for the remainder of the financial year.

9.2. In 2010/11 investment of surplus cash was managed by the internal treasury team. The strategy for the in-house team was influenced by the need to keep funds relatively short for cash flow purposes. Lending continued to be restricted to UK banks, One Building Society, Nationalised and Part Nationalised Banks, UK Government and other Local Authorities in line with the Council's creditworthiness policy which was approved as part of the Annual Investment Strategy.

10. Investment outturn 2010/11

10.1 The tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in shorter term deposit rates. Bank rate remained at its historical low of 0.5% throughout the year.

10.2 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 stress testing of banks failing to calm counterparty fears. This highlighted the ongoing need for caution in treasury investment activity.

10.3 In light of the continued stresses on the world banking system, enhanced priority was given to security and liquidity in order to reduce counterparty risk. In order to counter the historically low investment rates, and following advice from Sector, use was made of direct deals with main UK banks which were part nationalised for various periods from three months to one year. Direct deals offered substantially enhanced rates over the equivalent rates available through brokers. This provided opportunities to lock into higher, long term rates at times when it was thought that they offered substantial enhancement over short term benchmark rates. Due to the enhanced market rates over bank rate this resulted in the total portfolio outperforming the benchmark. Continued use of an instant access account with the Council's own bankers, Natwest, was also used as this account offered both instant access to funds and paid a rate which was higher than placing short term deposits through brokers.

10.4 Movements in short term rates through the year are shown in the graph at Appendix A.

10.5 Throughout the year the level of interest rates were lower than budgeted as interest rates remained at historically low levels. This resulted in the internal treasury team achieving a lower level of interest on revenue balances than budgeted. This £415,000 shortfall was offset by an under spend on debt charges of £1.9 million due to no long term borrowing being undertaken in

2010/11. The £1.485 million under spend was used to fund mainly budget corrections and voluntary severance costs.

10.6 At 31 March 2011 the allocation of the cash portfolio was as follows:

	£m
• In-house short dated deposits for cash flow management	31.5
• In-house long dated deposits (up to 1 year)	18.0
• Other Local Authorities	16.6
Total	**66.1**

10.7 The following table shows the average return on cash investments for the internal treasury team during the year and for the last 3 years to 31 March 2011. Recognising the need to manage short term cash flow requirements, the target for the internal team is the Local Authority 7 day deposit rate.

	Return 2010/11	Return 3 years to 31 March 2011
	%	% p.a.
Internal Treasury Team	0.77	2.03
Benchmark (Local Authority 7 Day LIBID rate)	0.36	1.46

10.8 The conclusions to be drawn from the table are:

- During 2010/11 the internal treasury team outperformed their benchmark by 0.41%.

- Over the 3 year period the internal team's performance has been 0.57% above the benchmark.

11. Landsbanki Deposit Update

11.1 Members will be aware that Bridgnorth District Council had £1 million invested in the Icelandic Bank, Landsbanki Islands. All local authorities who placed deposits with Landsbanki submitted claims to the Landsbanki Winding up Board in October 2009. All claims submitted were accepted as priority claims by the Board and have more recently been accepted as priority claims by the Icelandic courts however, this is currently subject to appeal. The latest position in relation to this investment is that Shropshire Council could receive 95% back of the principal sum invested however payments are likely to be delayed until December 2011 with annual payments thereafter and the final payment being made in December 2018.

12. Compliance with Treasury Limits and Prudential Indicators

12.1 All borrowing and lending transactions undertaken through the year have complied with the procedures and limits set out in the Council's Treasury Management Practices and Treasury Strategy. In addition, all investments made have been within the limits set in the approved counterparty list. No institutions, in which investments were made, showed any difficulty in repaying investments and interest in full during the year.

12.2 Appendix C shows the Prudential Indicators approved by Council as part of the 2010/11 and 2011/12 (revised estimate) Treasury Strategies compared with the actual figures for 2010/11. In summary, during 2010/11 treasury activities have been within the prudential and treasury limits set in the Treasury Strategy.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information) Council, 24 February 2011, Treasury Strategy 2011/12. Council, 09 December 2010, Treasury Strategy 2010/11 Mid Year Review. Council, 25 February 2010, Treasury Strategy 2010/11. Cabinet, 15 September 2010, Treasury Management Update Quarter 1 2010/11. Cabinet, 10 November 2010, Treasury Management Update Quarter 2 2010/11. Cabinet, 15 February 2011, Treasury Management Update Quarter 3 2010/11. Cabinet, 11 May 2011, Treasury Management Update Quarter 4 2010/11.
Cabinet Member: Mike Owen, Portfolio Holder
Local Member N/A
Appendices A. Movement in Interest Rates 2010/11 B. Debt Maturity Profile as at 31 March 2011 C. Prudential Indicators 2010/11