REPORT FOR: CABINET

Date:	22 June 2011
Subject:	Treasury Management Outturn Report 2010/11
Key Decision:	No
Responsible Officer:	Julie Alderson, Interim Director of Finance
Portfolio Holder:	Councillor Bill Stephenson, Leader and Portfolio Holder for Finance and Business Transformation
Exempt:	No
Decision subject to Call-in:	No
Enclosures:	Appendix 1 – Prudential Indicators

Section 1 – Summary and Recommendations

This report sets out the summary of Treasury Management activities for 2010/11

Recommendations:

(a) Note the outturn position for Treasury Management activities for 2010/11.
(b) Refer this report to GARMC for review.

Reason: (For recommendation)

(a) To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.
(b) To keep Cabinet Members informed of Treasury Management activities and performance.

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Section 2 – Report

Introduction

1. Treasury Management is the management of the Council's investments and cash flows, its banking, money market and debt transactions together with the effective control of the risks associated with those activities.

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 prudential and treasury indicators for 2010/11. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3. During 2010/11 the minimum reporting requirements were that the full Council should receive the following reports:

   - An annual treasury strategy in advance of the year (Cabinet 11 February 2010).
   - A mid year treasury update report (Cabinet 15 December 2010).
   - An annual report following the year end describing the activity compared to the strategy (this report)

4. Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies. The additional requirements for scrutiny have been delegated to the Governance Audit Risk Management Committee (GARMC) and this report will be submitted to GARMC. The Treasury Management Group chaired by the Corporate Director of Finance meets monthly to review treasury activity.

5. This annual treasury report covers

   - overall outturn position on treasury management,
   - Council's treasury position as at 31 March 2011,
   - economy in 2010/11,
   - borrowing outturn for 2010/11,
   - investment outturn for 2010/11; and
   - compliance with treasury limits and Prudential Indicators.

Outturn Position

6. There was a favourable variance of £1.1 million on the updated capital financing budget of £23.3 million as detailed below:-

	Latest Budget	Outturn	Variation	
	£000	**£000**	**£000**	**%**
Cost of Borrowing	11,376	11,239	-137	-1.2
Investment Income	-747	-1,065	-318	42.6
Minimum Revenue Provision	12,674	12,062	-612	-11.0
Total	**23,303**	**22,236**	**-1,067**	**-4.6**

7. The favourable outcome arose due to:

(a) Borrowing – gross borrowing costs (excluding allocations and finance lease interest) were lower (actual £11.88 million, budget £12.22 million) as borrowing rates in 2009-11 were lower than anticipated through the use of LOBO structures.

(b) Income – both the average interest rate earned (1.3% and the average balance £127 million) were higher than the budget (1.25% and £100 million). Interest allocations to third parties, HRA, schools etc were also greater than the budget (actual £625,000 v budget £503,000).

(c) MRP – The favourable variance results mainly from projects worth approximately £5 million not completed within the original planned timescales and £2 million under spend in 2009/10 on capital projects funded from borrowing.

Treasury Position as at 31 March 2011

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

	31st March 2011	**Average Rate**	**Average Life yrs**	31st March 2010	Average Rate	Average Life yrs
	£m	**%**	**Yrs**	£m	%	Yrs
Fixed Rate Borrowing						
Public Works Loan Board (PWLB)	130.0	4.50	32.8	130.3	4.49	33.7
Market	131.8	4.65	36.4	111.8	4.85	36.9
Total Debt	**261.8**	**4.57**	**34.6**	**242.1**	**4.66**	35.2
Investments:						
In-House	112.9	1.30	219 days	95.3	2.25	121 days
Total Investments	**112.9**			**95.3**		

9. Details on borrowing and investment activities follow in the report.

The Economy and Interest Rates

10. 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.

11. 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 as increases in world oil prices helped to dampen international economic growth prospects. Planned Government spending cuts are also expected to act as a significant drag on growth.

12. 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. However, this positive performance was mostly reversed in the closing months of 2010 as sentiment changed due to sharply rising inflation pressures.

13. The developing Euro zone peripheral sovereign debt crisis caused considerable concerns in financial markets. Greece, Ireland, and Portugal were forced to accept assistance from a combined EU / IMF rescue package. These worries caused international investors to seek safe havens by investing in non-Euro zone government bonds.

14. Deposit rates picked up modestly in the second half of the year as rising inflationary concerns fed through to prospects of an earlier start to increases in 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.

Borrowing Outturn for 2010/11

15. Total long term debt of £261.8 million at the end of March 2011 is made up £131.8 million bank loans and £130.0 million PWLB loans.

16. The following activities were carried out in respect of Long Term Borrowing:-

- £20 million borrowed from RBS on 25 May 2010 structured as Lender's Option Borrower's Option (LOBO). The loan has a maturity of 40 years and a fixed interest rate of 3.5% (see note below).

The table below sets out the borrowing maturity profile

	31st March 2011		31st March 2010	
	£m	**%**	£m	%
Under 12 Months	0.0	0.0	0.1	0.0
12 Months and under 24 Months	0.0	0.1	0.2	0.1
24 Months and within 5 years	10.0	3.8	10.0	4.1
5 years and within 10 years	38.0	14.5	26.0	10.8
10 years and above	213.8	81.7	205.8	85.0
Total	**261.8**	**100.0**	242.1	100.0

17. As highlighted in section 8, the average interest rate on debt has moved over the course of the year from 4.66% to 4.57**%.** The approach to funding capital expenditure during the year was two fold. Firstly to use internal funds in recognition of the unfavourable gap between investment returns and borrowing costs and secondly to draw longer term fixed rate debt, to take advantage of low long term rates and reduce exposure to fluctuations in short term interest rates.

18. In aggregate there is £83.8 million of LOBO structured borrowing shown in the table above as having maturities of between 40 and 68 years. The lenders are permitted to reset interest rates in approximately 2 – 5 years (and annually thereafter) such that these loans may have to be repaid and refinanced sooner than the stated maturity.

Investment Outturn for 2010/11

19. Interest rates have remained at historic lows in the year. The Bank of England base rate has remained at 0.5% since March 2009 while 7 day and 3 month Libid rates of 0.53% (2009: 0.53%) and 0.61% (2009: 0.73%) respectively have made investing over short horizons unattractive. The investment portfolio achieved an average return of 1.30% in the year, exceeding both the 7 day and 3 month Libid rates.

20. The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list. The Council will invest for a range of periods from overnight to five years, dependent on the Council's cash flows, its interest rate view and the interest rates on offer. During the year all investments were made in full compliance with this Council's treasury management policies and practices.

21. At 31st March 2011 the investment portfolio is invested over a spread of maturities from overnight to three years, although the majority is keep short term due to uncertainties over interest rate movements and future cashflow timing. At the year end £48.5 million has remaining maturities of over 6 months and £18 million over 12 months.

22. Most deposits are with UK High Street Banks (Barclays, Lloyds, HBOS, RBS, Santander) with Nationwide the only building society and Svenska Handelsbanken the only overseas bank. In addition, three money market funds offering daily liquidity are used.

23. The returns from the investment portfolio are benchmarked by the treasury advisor, Sector, and in the year the weighted average return calculated by Sector of 1.48% exceeded both their model portfolio (1.39%) and the average of other London Boroughs (1.26%).

24. The table below sets out the investment balances as at 31 March 2011.

	31st March 2011		31st March 2010	
	£m	**%**	£m	%
Specified Investments				
Banks & Building Societies	105.2	93.2	75.4	79.1
Money Market Funds	7.7	6.8	14.9	15.7
Non –Specified Investments				
Building Societies	0.0	0.0	5.0	5.2
Total	**112.9**	**100.0**	95.3	100.0

25. Included in the above balances are funds of £29.9 million as at 31 March 2011 invested on behalf of the pension fund and the West London Waste Authority. In aggregate 40% of interest earned is allocated both to these balances and internal funds (schools, housing, insurance etc). From 1st April 2011, pension fund balances are invested separately from the Council to comply with new regulations.

Compliance with Treasury Limits

26. The prudential framework for local authority capital investment was introduced through the Local Government Act 2003. The prudential system provides a flexible framework approach within which capital assets can be procured, managed, maintained and developed. Under this framework, individual authorities are responsible for deciding the level of their affordable borrowing for the Council's capital investment plans that is demonstrated to be affordable, prudent and sustainable.

27. The Act and the supporting regulations require the Council to have regard to the Prudential Code and to set Prudential Indicators for the next three years. The indicators for 2010/11 were approved by the Cabinet in February 2010. During the financial year the Council operated within the treasury limits and Prudential Indicators as shown in Appendix 1.

28. The total capital expenditure for 2010/11 was £57.9 million. Approximately £35.7 million (62% of the total expenditure) was funded from grants, revenue contributions and capital receipts. This resulted in the borrowing requirement of £22.2 million.

Minimum Revenue Provision (MRP)

29. Under the statutory regulations a Minimum Revenue Provision is made each year to repay the outstanding debt on assets. This is calculated by spreading the capital expenditure over the useful life of the asset.

Financial Implications

30. Financial matters are integral to the report.

Environmental Impact

31. There are no direct environmental impacts.

Performance Issues

32. The Council meets the requirements of the CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practices for the Treasury Management function

Risk Management Implications

33. The identification, monitoring and control of risk are central to the achievement of the treasury objectives. Potential risks are identified, mitigated and monitored in accordance with treasury practice notes approved by the Treasury Management Group.

    Risk included on Directorate risk register? Yes
    Separate risk register in place? No

Equalities Implications

34. There is no direct equalities impact.

Corporate Priorities

35. This report deals with the Treasury Management Strategy which is a key to delivering the Council's corporate priorities

Section 3 - Statutory Officer Clearance

Name: Julie Alderson Date: 27 May 2011	√	Chief Financial Officer
Name: Jessica Farmer Date: 24 May 2011	√	on behalf of the Monitoring Officer

Section 4 – Performance Officer Clearance

Name: Alex Dewsnap Date: 18 May 2011	√	Divisional Director Partnership, Development and Performance

Section 5 – Environmental Impact Officer Clearance

Name: John Edwards Date: 18 May 2011	√	Divisional Director (Environmental Services)

Section 6 - Contact Details and Background Papers

Contact: George Bruce (Treasury and Pension Fund Manager, Finance & Procurement) Tel: 020-8424-1170 / Email: george.bruce@harrow.gov.uk

Background Papers: N/A

Call-In Waived by the Chairman of Overview and Scrutiny Committee	**NOT APPLICABLE** *[Decisions for noting are not subject to Call-in]*

PRUDENTIAL INDICATOR	2009/10	2010/11	2010/11
	Actual	Approved	Actual
	£'000	£'000	£'000
Capital Expenditure			
Non - HRA	84,822	38,028	52,645
HRA	11,163	7,610	5,302
Total Expenditure	**95,985**	**45,638**	**57,947**
Funding:-			
Grants	57,638	11,329	26,101
Capital Receipts	1,314	250	5,462
Revenue Financing	0	500	290
Major Repairs Allowance	3,778	3,932	3,932
Internal Borrowing	3,255		2,162
External Borrowing	30,000	29,627	20,000
	95,985	**45,638**	**57,947**
Ratio of financing costs to net revenue stream			
Non - HRA	9.74%	11.74%	12.95%
HRA	25.03%	29.11%	24.82%
Net borrowing requirement			
brought forward 1 April	144,667	186,999	182,054
carried forward 31 March	182,054	171,328	195,898
in year borrowing requirement	**37,387**	**-15,671**	**13,844**
Capital Financing Requirement (CFR) as at 31 March			
Non – HRA	238,433	225,997	251,470
HRA	54,487	59,186	55,197
Total	**292,920**	**285,183**	**306,667**
Annual Change in CFR - General Fund	17,358	8,135	13,037
Annual Change in CFR - HRA	6,894	3,536	710
Total Annual Change in CFR	**24,252**	**11,671**	**13,747**
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	42.35	24.12	21.14
Increase in average housing rent per week	2.07	3.41	0.07
Authorised Limit for external debt			
Borrowing	269	296	262
Other long term liabilities	19	0	26
Total	**288**	**296**	**288**
Operational Boundary for external debt			
Borrowing	269	274	262
Other long term liabilities	18	0	26
Total	**287**	**274**	**288**
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing	269	274	262
Upper limit for variable rate exposure			
Net principal re variable rate borrowing	0	115	0
Upper limit for principal sums invested over 364 days	7	25	18

Maturity structure of fixed rate borrowing during 2010/11	upper limit	lower limit	Actual March 2011	
	%	%	£m	%
under 12 months	20	0	0.00	0.00
12 months and within 24 months	20	0	0.00	0.00
24 months and within 5 years	30	0	16.00	6.11
5 years and within 10 years	40	10	32.00	12.22
10 years and above	90	30	213.80	81.67
Total			261.80	100.00

Comments on Prudential Indicators

1. General Fund capital expenditure of £53 million in 2010-11 is £12 million higher than that approved in February 2010 although considerably lower than the level projected at mid year. HRA capital expenditure of £5 million is below plan (£8 million).

2. Despite the higher capital expenditure, new borrowing of £22 million is £8 million below plan due to grants (£26 million) being more than double expectation (£11 million).

3. The ratio of Non-HRA financing costs to revenue includes finance lease costs in the 2009/10 and 2010/11 actuals but not the plan. Savings in MRP and additional investment income have impacted positively on the ratio for the general fund, while lower borrowing has resulted in a favourable outcome for HRA financing cost ratio.

4. The net borrowing requirement has increased by £24.6 million compared with the plan, mainly due to the inclusion of finance lease balances £20.4 million and the approval of additional capital expenditure.

5. The additional Capital Financing Requirement as at 31 March 2011 of £21.5 million compared to plan is again due to the capitalisation of finance lease assets.

6. The incremental impact of capital investment decisions both on council taxes and rent is less than predicted due to the beneficial effect of higher than expected grants reducing the required borrowing to support capital expenditure.