NORTH WEST LEICESTERSHIRE DISTRICT COUNCIL

AUDIT AND GOVERNANCE COMMITTEE – 3 FEBRUARY 2011

Title of report	**TREASURY MANAGEMENT ACTIVITY – APRIL TO DECEMBER 2010**
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Purpose of report	To inform Members of the Council's cumulative Treasury Management activity undertaken during the period April to December 2010.
Reason for Decision	To ensure Members are informed of the Council's Treasury Management activity during the financial year and have the opportunity to scrutinise that activity.
Strategic aims	Organisational Development
Implications:	
Financial/Staff	Not applicable
Link to relevant CAT	Could impact upon all CAT's.
Risk Management	Borrowing and investment both carry an element of risk. This risk is moderated through the adoption of Treasury and Investment Strategies, adoption of and compliance with the CIPFA code of Treasury Management and the retention of Treasury Management Consultants (Arlingclose) to proffer expert advice.
Equalities Impact Assessment	Not applicable
Human Rights	Not applicable
Transformational Government	Not applicable

Consultees	None
Background papers	The CIPFA Code of Practice on Treasury Management The Council's Treasury Management Strategy The Council's Borrowing and Debt Rescheduling Strategies The Council's Investment Policy and Strategy These documents are located in Room 35.
Recommendations	**MEMBERS NOTE THIS REPORT AND COMMENT AS APPROPRIATE.**

1.0 BACKGROUND.

1.1 Treasury Management in Local Government is governed by the CIPFA Code of Practice on Treasury Management in the Public Services and in this context is defined as "the management of the Council's cash flows, its banking and its capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks". This Council adopted the CIPFA Code on 2 July 2002, re-affirmed the adoption on 15 June 2009, and **complies with its requirements**.

The Council adopted a Treasury Management Policy Statement on 24 August 2004 and re-affirmed the adoption on 15 June 2009. **The Council's current Treasury Strategy, including the Annual Investment Strategy, Borrowing Strategy, Debt Rescheduling Strategy and Prudential Indicators were approved by Council on 30 March 2010.**

1.2 In March 2009 CIPFA released a Treasury Management Panel Bulletin on Treasury Management in Local Authorities – Post Icelandic Banks Collapse, providing interim advice to local authorities on treasury management practices in the light of the Icelandic banks collapse in 2008 and the continuing 'credit crunch'. In order to enshrine best practice it is suggested that authorities report formally to Members on treasury management activities at least twice a year and preferably quarterly.

1.3 Financial year 2010/11 is the second year in which treasury management activity has been reported to Members during the year. In 2009/10 this activity was reported to the Corporate Governance Scrutiny Committee. This report is the second in-year report of 2010/11, to inform Members of the Council's treasury activity and enable scrutiny of the performance. It will supplement the annual Treasury Stewardship Report, which is presented to Members as soon as possible after the end of each financial year.

2.0 SCOPE.

2.1 This report has been:

(a) prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code;
(b) presents details of capital financing, borrowing, debt rescheduling and investment transactions;
(c) gives details of the treasury management transactions for the period April to December 2010.
(d) confirms compliance with treasury limits and Prudential Indicators.

3.0 THE ECONOMIC BACKGROUND.

- The UK continued to emerge from recession, with Q3 2010 GDP registering growth of 0.7%. Mortgage repayment, a reduction in net consumer credit and weaker consumer confidence are consistent with forecasts of lower consumption and lower trend growth in the year ahead.
- Consumer price inflation remains stubbornly above the Bank of England's 2% target and could spike in excess of 4% in January 2011 as VAT, utilities and rail fares are increased.
- Unemployment remains near a 16 year high at just over 2.5 million and could increase as the public sector sheds jobs.
- The Bank of England's Monetary Policy Committee has maintained the Bank Rate at 0.5% and Quantitative Easing (QE) at £200bn. This reflects the fragility of the recovery and the significantly greater fiscal tightening of the emergency budget.
- The US Federal Reserve downgraded its outlook for US growth. As a result the FED has signalled that further QE through asset purchases may be required, and kept rates on hold at 0.25%. The ECB maintained rates at 1%.
- The major ongoing worries in Europe focussed on sovereign weakness in Portugal, Italy, Ireland, Greece and Spain, the exposure of the continent's banking sector to the sovereign and corporate debt of these nations and the risk of contagion extending to other countries.

4.0 THE COUNCIL'S TREASURY POSITION.

4.1 The Council's gross / net debt and investment positions as at 31 December 2010 are as follows:

DEBT	Balance at 01/4/2010 £m	%	Maturing loans £m	Premature redemptions £m	New Borrowing £m	Balance at 31/12/2010 £m	%
Long-term fixed rate	£15.440m	100	£0m	£2.750m	£0m	£12.690m	100
Long-term variable rate	£0m	0	£0m	£0m	£0m	£0m	0
Temporary Borrowing	£0m	0	£0m	£0m	£0m	£0m	0
Total borrowing	£15.440m	100	£0m	£2.750m	£0m	£12.690m	100
Other long-term liabilities	£0.185m					£0.185m	
TOTAL EXTERNAL DEBT	**£15.625m**					**£12.875m**	
INVESTMENTS	Balance at 01/4/2010 £m	%	Maturities £m	Sales £m	New Investments £m	Balance at 31/12/2010 £m	%
Internally Managed	£4.652m	100	£79.374m	£0m	£89.326m	£14.604m	100
Investments with maturities up to 1 year,	£4.652m	100	£79.374m	£0m	£89.326m	£14.604m	100
Investments with maturities in excess of 1 year	£0m	0	£0m	£0m	£0m	£0m	0
Externally Managed Investments	£0m	0	£0m	£0m	£0m	£0m	0
TOTAL INVESTMENTS	£4.652m		£79.374m	£0m	£89.326m	£14.604m	
NET DEBT	**£10.973m**					**(£1.729m)**	

4.2 Members will note the reduction in the Council's net debt of £12.702m during the period. A number of factors brought about this situation.

- The Council traditionally benefits from receipt of major income streams (e.g. Council Tax & NNDR) during the first ten months of the financial year.

- The Council's traditional pattern of revenue expenditure is more evenly weighted throughout the financial year.
- The Council's expenditure of its capital programme is heavily weighted towards the latter part of the financial year because of the time required to schedule programmes of work and award contracts, which are paid upon completion.
- The above patterns of income and expenditure are reflected in the Council's cash flow projections, which are monitored and revised on a daily basis. The above position is forecast to unwind in the last three months of the financial year and this is in line with our traditional experience.
- The cash flow benefits discussed above do present the Council with investment opportunities and this is reflected in the level and period of investments discussed at 7.3 below.

5.0 BORROWING ACTIVITY.

5.1 The Council's Borrowing Strategy, approved by Council on 30 March 2010, incorporates a prudent and pragmatic approach to borrowing to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators.

5.2 The Council's estimated borrowing requirement for the current financial year was a net repayment of £26k and for the two subsequent financial years is to repay £509k in 2011/12 and £992k in 2012/13.

5.3 No new long term loans were raised during the period. Additionally, no existing loans requiring replacement matured during the period.

5.4 The Council's cash flow remained mostly positive during the period. However, the Council did require five temporary overnight loans, totalling £2.72m at an average rate of 0.48%.

6.0 DEBT RESCHEDULING ACTIVITY.

6.1 The Council's policy on debt rescheduling, as approved by Council on 30 March 2010, is to maintain a flexible approach where the rationale for rescheduling could be one or more of the following:

- Savings in interest costs with minimal risk.
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio.
- Amending the profile of maturing debt to reduce any inherent refinancing risks.

All rescheduling activity will comply with the accounting requirements of the local authority SORP and regulatory requirements of the Capital Finance and Accounting Regulations (SI 2007 No 573 as amended by SI 2008/414).

6.2 The Council undertook no debt rescheduling activity during the period.

6.3 In November 2010, the Council repaid two PWLB loans, shown below, totalling £2.75m and financed this from monies that would otherwise have been available for investment.

PWLB LOAN REFERENCE	PRINCIPAL	INTEREST RATE (%)
614 05213 490890	£1,000,000	4.15
614 05213 492774	£1,750,000	4.35

6.4 As Members will note, the rate of interest payable on both loans is considerably higher than can currently be achieved from investment returns.

6.5 The Council's portfolio of six loans, two PWLB loans and four market loans, will continue to be monitored for debt rescheduling / repayment opportunities that comply with the Council's Policy and rationale.

7.0 INVESTMENT POLICY AND ACTIVITY.

7.1 The Council's specific policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital; and,
- an optimum yield which is commensurate with security and liquidity.

The revised counterparty list, approved by Council on 30 March 2010 restricts new deposits to the following:

- the Debt Management Office
- Other local authorities
- AAA-rated Stable Net Asset Value Money Market Funds
- Banks / Building Societies which have, as a minimum, **all** of the following credit ratings

Fitch short term credit rating of F1+
Moody's short term credit rating of P-1
Standard & Poors short term credit rating of A-1+

AND / OR

UK incorporated institutions who can participate in the UK Government 2008 Credit Guarantee Scheme (CGS).

The CGS was announced in October 2008 to stabilise the UK banking system and provide solvency support for the "systemically critical" banking institutions in the UK. The government's CGS is not an explicit guarantee for deposits but it is the main platform to maintain the solvency of institutions critical to the UK's financial stability.

Whilst strengthening still further the previous counterparty credit quality requirements, the revised investment criteria further reduced the number of banks and building societies with which the Council can now place its investments.

7.2 The Council invested average daily cash balances of £10.446m during the period. These represent working cash balances / capital receipts and the Council's reserves. Their security is the overriding feature of the Council's treasury management activities. The investment returns generated from those balances are important since they make a significant contribution to the Council's overall financial position.

7.3 There were 216 investments during the period, totalling £89.326m, of which the following contributed most to the overall rate of return.

PRINCIPAL	PERIOD	RATE	COUNTERPARTY
£5M	1/4/2010-30/3/2011	1.7%	NATIONWIDE B.S.
£3M	8/6/2010-8/3/2011	1.5%	LLOYDS TSB
£2m	23/8/2010-3/2/2011	1.2%	LLOYDS TSB
TOTAL - £10m	**WEIGHTED AVERAGE RATE**	**1.54%**	

The remaining investments were placed in call account facilities with the Alliance & Leicester Commercial Bank and Bank of Scotland. Both accounts provide for daily deposits / withdrawals at competitive interest rates, whilst incurring virtually no administration costs.

7.4 **The average rate of return on the Council's investment balances during the period was 1.41%.** For comparison purposes, the benchmark return (average 7-day BID/BOR rate) for the same period was 0.49%.

All investments made during the quarter complied with the council's agreed Treasury Management Strategy, Prudential Indicators, Treasury Management Practices and prescribed limits.

All maturing investments were repaid to the council on the due date and in full, including interest.

8.0 COMPLIANCE WITH TREASURY LIMITS AND TREASURY-RELATED PRUDENTIAL CODE INDICATORS.

8.1 The Council, at its meeting on 30 March 2010, approved the Prudential Indicators for 2010/11. These are set out and described below.

(a) **Authorised Limit**: This is the maximum amount of external debt that can be outstanding at one time during the financial year. The limit, which is expressed gross of investments, is consistent with the Council's existing commitments, proposals for capital expenditure and financing and with its approved Treasury Policy and Strategy and also provides headroom over and above for unusual cash movements. **This limit was approved at £19.5m for 2010/11.**

(b) **Operational Boundary**: This limit is set to reflect the Council's best view of the most likely prudent (i.e. not worst case) levels of borrowing activity and is based on the Authorised Limit excluding the headroom for unusual cash movements. **For 2010/11 the limit was approved at £17.5 m.**

The levels of debt are measured on an ongoing basis during the year for compliance with the Authorised Limit and the Operational Boundary. **The Council maintained its total**

external borrowing and other long-term liabilities within both limits; at its peak this figure was £16.575m.

(c) Upper Limits for Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The exposures are calculated on a net basis, i.e. fixed rate debt net of fixed rate investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Estimated %	Actual %
Upper Limit for Fixed Rate exposure	100%	100%
Upper Limit for Variable Rate exposure	50%	0%

(d) Maturity Structure of Fixed Rate borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate.

	Upper limit %	Lower limit %	Actual Borrowing as at 31/12/2010 £	Percentage of total as at 31/12/2010 %
under 12 months	50%	0%	£0	**0%**
12 months and within 24 months	50%	0%	£0	**0%**
24 months and within 5 years	60%	0%	£1m	**8%**
5 years and within 10 years	80%	0%	£0	**0%**
10 years and within 20 years	100%	0%	£2.5m	**20%**
20 years and within 30 years	100%	0%	£0	**0%**
30 years and within 40 years	100%	0%	£0	**0%**
40 years and within 50 years	100%	0%	£0	**0%**
50 years and above	100%	0%	£9.19m	**72%**

(e) Total principal sums invested for periods longer than 364 days

This indicator is set in order to allow the Council to manage the risk inherent in investments longer than 364 days. **For 2010-11 this limit was approved at £4m. During the period the Council undertook no investments for longer than 364 days.**