Haringey Council

Agenda item:

Corporate Committee **On 20 June 2010**

Report Title.	**Treasury Management 2010/11 out-turn & Quarter 1 2011/12 update**
Report of: Signed :	**Director of Corporate Resources** J. Parker 10/6/11 **Julie Parker**
Contact Officer :	**Nicola Webb, Head of Finance: Treasury & Pensions** **Telephone 020 8489 3726**
Wards(s) affected: All	Report for: Noting

1. Purpose of the report

1.1 To report to members on treasury management activity and performance during 2010/11 in accordance with the CIPFA Treasury Management Code of Practice.

1.2 To update members on treasury management activity during the first quarter of 2011/12.

2. Introduction by Cabinet Member

2.1 Not applicable.

3. State link(s) with Council Plan Priorities and actions and /or other Strategies:

3.1 Not applicable.

4. Recommendation

4.1 That Members note the Treasury Management activity and performance during 2010/11 and the first quarter of 2011/12.

5. Reason for recommendation

5.1 To ensure members are aware of the Treasury Management activities undertaken during 2010/11 and in the first quarter of 2011/12.

6. Other options considered

6.1 None.

7. Summary

7.1 This report sets out the Council's Treasury Management activity and performance during 2010/11 as required by the CIPFA Treasury Management Code of Practice. In addition it provides an update on activity in the first two months of 2011/12.

7.2 During the year £52m of long term borrowing matured and £47m was borrowed. The difference was financed through use of cash balances. The total borrowing at the end of the year was £630.8m. The cash balances averaged £43m during the year and the average interest earned was 0.61%.

8. Head of Legal Services Comments

8.1 The Head of Legal Services has been consulted on the content of this report and comments that its content is within the policy agreed by Council and is consistent with the purposes of Financial Regulations. There are no specific legal implications arising from the content of the report.

9. Equalities & Community Cohesion Comments

9.1 There are no equalities issues arising from this report.

10. Consultation

10.1 Not applicable.

11. Financial Implications

11.1 The total cost of borrowing during 2010/11 was £42.4m and the interest earned was £261k. This contributed to the £2.2m underspend against debt financing costs reported in the out-turn report to Cabinet on 7th June 2011. The underspend arose due to the use of internal cash balances in lieu of borrowing. This report shows that £5m of the loans which matured in 2010/11 were not replaced and a significant proportion of the new borrowing was not taken until the end of the financial year. These actions minimised financing costs.

12. Use of appendices

12.1 Appendix 1 – Summary of 2010/11 Treasury Management Activity & Performance
Appendix 2 – 2010/11 Prudential Indicators

13. Local Government (Access to Information) Act 1985

13.1 The following background papers were used in the preparation of this report:

- Financial Planning Report for 2010/11 to 2012/13 reported to Council and agreed on 22nd February 2010.
- Reports to General Purposes Committee dated 28th June 2010, 23rd September 2010 and 11th January 2011.

For access to the background papers or any further information please contact Nicola Webb, Head of Finance: Treasury & Pensions, on 0208 489 3726.

14. Background

14.1 The Council's treasury management activity is underpinned by CIPFA's Treasury Management Code of Practice which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year, including a report reviewing the activity of the previous financial year within six months of it ending. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities, and enable those with ultimate responsibility for the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.

15. Economic and treasury portfolio background in 2010/11

15.1 At the time of determining the Treasury Management Strategy Statement for 2010/11 in February 2010, interest rates were expected to remain low in response to the fragile state of the UK economy. The UK Bank Rate had been cut to 0.5% in March 2009 and had remained at this level throughout 2009/10. This continued throughout 2010/11, as the Bank of England tried to balance lacklustre growth and rising inflation.

15.2 This background meant short term investment rates remained only marginally above 0.5% during 2010/11. As part of the Spending Review in October 2010, the interest rates payable on borrowing from the PWLB increased to 1% above the government's cost of borrowing. This was done with immediate effect for all new borrowing increasing all rates by 0.87%. The Council's existing borrowing was unaffected by this.

15.3 The position of the treasury portfolio at the end of the financial year compared to the previous financial year end is shown in the table overleaf. This shows that in total the borrowing and investment positions had not changed significantly by the end of the year. However there was activity during the year as can be seen from the movements in the categories and the sections below describe this in relation to both investments and borrowing.

Treasury Portfolio	Position at 31/03/10 £000	Position at 31/03/11 £000
Borrowing		
PWLB Fixed Maturity	490,811	460,806
PWLB Fixed EIP	0	24,000
PWLB Variable EIP	20,000	18,000
Market loans	125,005	125,000
Other Local authorities	0	3,000
Total External Borrowing	635,816	630,806
Investments		
Fixed Term Deposits	6,100	3,400
Call Accounts	17,006	10,400
Money Market Funds	0	14,235
Total Investments	23,106	28,035

16. Long Term Borrowing

16.1 The Council's borrowing requirement for 2010/11 was estimated in February 2010 to be £41m. In addition £52m of loans were due to mature during 2010/11 and required re-financing.

16.2 The Prudential Code permits the Council the flexibility to bring forward or defer borrowing in relation to its Capital Financing Requirement. During the year the significant differential between debt costs and investment earnings seen in 2009/10 continued. In order to eliminate the high "cost of carry" associated with the higher cost of long term borrowing compared to temporary investment returns (between 0.5% and 1%), the Council continued to use internal resources in lieu of borrowing for the majority of the financial year. By doing so, the Council maintained a low overall treasury risk during the year, however it was recognised that utilising investments in lieu of borrowing clearly had a finite duration and so liquidity was monitored closely throughout the year.

16.3 The PWLB remained the Council's preferred source of borrowing given the transparency and control that its facilities continue to provide. Loans that offered the best value in an interest rate environment with a large differential between short term and long term rates were PWLB medium term Equal Instalments of Principal (EIP) loans and temporary borrowing from the market.

16.4 The movements on the borrowing portfolio during 2010/11 are summarised below:

	Balance at 01/4/10 £000	Maturing loans £000	New Borrowing £000	Balance at 31/3/2010 £000
PWLB Fixed Maturity	490,811	(50,005)	20,000	460,806
PWLB Fixed EIP	0	0	24,000	24,000
PWLB Variable EIP	20,000	(2,000)	0	18,000
Market loans	125,005	(5)	0	125,000
Other Local Authority	0	0	3,000	3,000
Total borrowing	635,816	(52,010)	47,000	630,806

16.5 £20m of PWLB fixed rate maturity borrowing was taken at the end of August 2010 for 50 years when rates reached their lowest level for 3 years. The rate achieved was 3.92%. In February cash balances had dropped to such a level that the Council's liquidity was at risk and so three EIP loans were taken from the PWLB for 6 years at an average rate of 2.97%. In addition £3m was borrowed from another local authority for a period of one year for 1.35%.

16.6 The Council's borrowing costs were £42.4m in total and the average rate payable on the portfolio had fallen to 6.8% by the end of the financial year.

16.7 In all its borrowing activity, the Council complied with the prudential indicators set for 2010/11. All borrowing decisions, including the decision to use internal balances, were taken following advice from the Council's Treasury Management Advisor, Arlingclose Ltd.

16.8 As a result of the planned reform of Council Housing Finance, the Council is expecting a reduction in debt of £242m. The Communities and Local Government Department proposes to settle this by repaying a proportion of each of the Council's PWLB loans. The treasury management implications of this are being reviewed with the Council's treasury management advisers.

17. Investments – activity and performance in 2010/11

17.1 The Council held average cash balances of £43m during the year. The balances represented working cash balances and the Council's reserves. The Council invested these funds in accordance with the Treasury Management Strategy Statement agreed for 2010/11. All investments made during the year complied with the Council's agreed Treasury Management Strategy, Prudential Indicators, Treasury Management Practices and prescribed limits. Maturing investments were repaid to the Council in full and in a timely manner.

17.2 The Council's investment priorities set out in the 2010/11 strategy were:
1) Security of the invested capital;
2) Liquidity of the invested capital;
3) An optimum yield which is commensurate with security and liquidity.

The investments placed by the Council during 2010/11 reflected these priorities.

17.3 Counterparty credit quality was assessed and monitored with reference to credit ratings (the Council's minimum long term counterparty rating of A+ across all three rating agencies – Fitch, Standard & Poors and Moody's); credit default swaps; any potential support mechanisms from the UK government and share price.

17.4 The Council has sought to minimise its security risk by setting limits on each institution on the lending list. The Council has complied with all these limits during 2010/11. In addition officers have sought to spread the deposits across the available institutions to further minimise security risk. The table below shows a breakdown of the Council's deposits on 31st March 2011:

Institution	Long Term Credit Rating	Amount (£k)	% of total deposits
Barclays Bank	AA-	3,400	12.1%
Santander UK	AA-	10,400	37.1%
BlackRock Money Market Fund	AAA	2,150	7.7%
JP Morgan Money Market Fund	AAA	500	1.8%
RBS Money Market Fund	AAA	11,585	41.3%
Total		**28,035**	

17.5 Throughout 2010/11 credit risk scores have been reported to General Purposes Committee, based on a methodology devised by Arlingclose, the Council's treasury management advisers. The scores show credit risk on a scale of 0 to 10 on both a value weighted and a time weighted basis and the table below demonstrates how to interpret the scores:

Above target	AAA to AA+	Score 0 - 2
Target score	AA to A+	Score 3 - 5
Below target	Below A+	Score over 5

17.6 The scores during 2010/11 are shown below:

	Quarter 1 2010/11	Quarter 2 2010/11	Quarter 3 2010/11	Quarter 4 2010/11
Value weighted	2.3	2.7	2.2	2.3
Time weighted	3.6	4.2	1.9	3.5

17.7 Liquidity has been maintained throughout the year through the extensive use of AAA rated money market funds and the instant access account with Santander UK. These investments offered instant access for a rate of return comparable to that achievable on a one month fixed term deposit.

17.8 The table below shows the Council's deposits at 31st March 2011, the term of each of the deposits and calculates the weighted average maturity of the portfolio. Due to the signficant use of instant access investments at present, the weighted average maturity at present is very low.

Institution	Days to maturity	Amount (£k)
Barclays Bank	14	3,400
Santander UK	1	10,400
BlackRock Money Market Fund	1	2,150
JP Morgan Money Market Fund	1	500
RBS Money Market Fund	1	11,585
Weighted Average Maturity	2.6	

17.9 £261k of interest was earned on the Council's investments during 2010/11 at an average rate of 0.61%, 0.11% above the Bank of England base rate.

18. Update on Icelandic deposits

18.1 The administration process for Heritable Bank is being undertaken by Ernst and Young in the UK. Their work is directed by the creditors' committee of which the Council is a member. 56% of Heritable deposits have now been returned – this amounts to £11.2m in the case of the Council. The overall expected recovery rate is still expected to be 80-85%.

18.2 In April 2011 the Icelandic District Court ruled that local authority deposits in Landsbanki and Glitnir have priority status. The other creditors have appealed this decision and the appeal will be heard by the Icelandic Supreme Court during 2011. The expected recovery rate of these deposits depends on the outcome of this appeal. The lawyers appointed on behalf of all local authorities are confident about that the outcome will be in favour of local authorities. If priority status is confirmed, then the expected recovery is 95% for Landsbanki and 100% for Glitnir. However if priority status is overturned then the recovery rates are expected to be 38% for Landsbanki and 29% for Glitnir.

19. Compliance with Prudential Code indicators

19.1 The Council set prudential indicators for 2010/11 in February 2010. The set of indicators is made up of those which provided an indication of the likely impact of the planned capital programme and those which are limits set on treasury management activity. Appendix 2 sets out the original indicators, the out-turn position for each of the capital indicators and the final year end position on each of the treasury management limits.

19.2 Detailed information about the capital expenditure figures can be found in the out-turn report submitted to Cabinet on 7th June 2011. The incremental impact of capital expenditure indicators are showing much lower levels than originally set. The original indicators showed the total Band D Council Tax and weekly housing rent, rather than only the portion related to capital expenditure not supported by grants.

19.3 None of the limits on treasury management have been breached in the year. Borrowing is significantly lower than was anticipated when the limits were set, due to the policy of using internal cash balances to fund the capital programme.

20. 2011/12 quarter 1 update

20.1 During the first two months of 2011/12 the cash balances have increased in line with the cashflow forecast. Therefore there has been no need to borrow and the total of the borrowing portfolio remains at £630.8m. The average cash balance in the period was £53.3m and the average interest rate earned was 0.67%.

20.2 Moody's placed Clydesdale Bank's long term rating on review for possible downgrade in February and in response to this they were immediately suspended from the lending list. There are no outstanding deposits with this bank. Although the rating of it's parent National Bank of Australia has since been downgraded, Clydesdale remains under review by Moody's. For this reason Clydesdale remain suspended.

20.3 The table overleaf shows the outstanding deposits at 31st May 2011. It can be seen that significant use is being made of call accounts and money market funds. These offer instant access with a rate only achievable with a fixed term deposit of 2-3 months.

Institution	Long Term Credit Rating	Period to maturity	Amount (£k)	% of total deposits
Nat West Call Account	A+	1	11,130	22.7
Santander UK Call Account	AA-	1	15,400	31.3
BlackRock Money Market Fund	AAA	1	8,020	16.3
Deutsche Money Market Fund	AAA	1	5,600	11.4
Invesco Money Market Fund	AAA	1	400	0.8
RBS Money Market Fund	AAA	1	8,590	17.5
Total			**49,140**	

20.4 The credit scores for the period were 2.58 on a value weighted basis and 1.75 on a time weighted basis. These scores are particularly low because of the instant access nature of the portfolio and the fact around half of the portfolio is invested in AAA rated money market funds.

20.5 During May there was one breach of the lending limits agreed by Council in February 2011. For one day the amount invested in the Deutsche Money Market Fund was £130,000 above the maximum allowable limit. It was identified the next day and immediately rectified. Procedures have been reviewed as a result of this to ensure it does not happen again.

Appendix 1: Summary of 2010/11 Treasury Management Activity and Performance

1. Treasury Portfolio 2010/11

	Quarter 4 £000	Quarter 3 £000	Quarter 2 £000	Quarter 1 £000
Long Term Borrowing PWLB	502,806	480,806	520,806	510,811
Long Term Borrowing Market	125,000	125,005	125,005	125,005
Short Term Borrowing	3,000	0	0	0
Total Borrowing	630,806	605,811	645,811	635,816
Investments	28,035	31,720	67,770	87,934
Icelandic deposits in default	26,989	27,928	28,788	30,030
Total Investments	55,024	59,648	96,558	117,964
Net Borrowing position	575,782	546,163	549,253	517,852

2. Security measure 2010/11

	Quarter 4	Quarter 3	Quarter 2	Quarter 1
Credit score – Value weighted	2.3	2.2	2.7	2.3
Credit score – Time weighted	3.5	1.9	4.2	3.6

3. Liquidity measure 2010/11

	Quarter 4	Quarter 3	Quarter 2	Quarter 1
Weighted average maturity: deposits (days)	2.58	1.0	13.8	41.3
Weighted average maturity: borrowing (years)	23.5	23.8	22.6	21.6

4. Yield measure 2010/11

	Quarter 4	Quarter 3	Quarter 2	Quarter 1
Interest rate earned	0.63%	0.63%	0.54%	0.66%
Interest rate payable	6.63%	6.71%	6.78%	7.00%

Appendix 2: 2010/11 Prudential Indicators

No.	Prudential Indicator	2010/11 Indicator		2010/11 Out- turn
CAPITAL INDICATORS				
1	Capital Expenditure	£169,699k		£154,903k
2	Ratio of financing costs to net revenue stream			
	General Fund	4.67%		5.34%
	HRA	33.39%		32.31%
3	Capital Financing Requirement	£718,766k		£716,449k*
4	Incremental impact of capital investment decisions			
	Band D Council Tax	£1,184.32		£8.22
	Weekly Housing rents	£83.20		£0.01
TREASURY MANAGEMENT LIMITS				
5	Authorised Limit	£900,000k		£653,468k
	Operational Boundary	£875,000k		£653,468k
6	Upper limit – fixed rate exposure	100%		97.1%
	Upper limit – variable rate exposure	40%		2.9%
7	Maturity structure of borrowing (U: upper, L: lower)	L	U	
	under 12 months	0%	25%	8.5%
	12 months and within 2 years	0%	25%	7.3%
	2 years and within 5 years	0%	50%	15.9%
	5 years and within 10 years	0%	75%	17.3%
	Over 10 years	0%	100%	51.1%
8	Sums invested for more than 364 days	£60,000k		£0
9	Adoption of CIPFA Treasury Management Code of Practice	√		√

* This figure is excluding operating leases converted to finance leases under IFRS.