AGENDA ITEM NO. …….

ISLE OF ANGLESEY COUNTY COUNCIL	
Report to	**County Council**
Date	**27 September 2012**
Subject	**Annual Treasury Management Review for 2011/12**
Portfolio Holder(s)	**Commissioner Mick Giannasi**
Lead Officer(s)	**Interim Head of Function (Resources)**
Contact Officer	**Einir Wyn Thomas (Ext. 2605)**

Nature and reason for reporting

To comply with regulations issued under the Local Government Act 2003.

This report is due to be presented to the Council by the end of September 2012. The Council has resolved that the report is also considered by the Audit Committee. The Audit Committee considered the report at its meeting on 24 July and resolved to accept the report and approve its contents for referral to the County Council.

Summary

The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2011/12. 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).

The report also includes borrowing and investment performance during the year.

Under the Prudential Code it is a requirement that all local authorities set Prudential Indicators for borrowing and investing among other factors each year. The Council confirmed its limits for 2011/12 on 8 March 2011 and outturn information is provided in this report.

During 2011/12 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year;
- a mid year (minimum) treasury update report;
- an annual review following the year describing the activity compared to the strategy (this report).

This Council also confirms that it has complied with the requirement under the Code to give scrutiny to the treasury management reports. The requirement for scrutiny (by the Audit Committee) was achieved, but the Second Quarter report was not referred to the County Council. This will be corrected for 2012/13.

Member training on treasury management issues was undertaken during January 2012 in order to support the scrutiny role of Members of the Audit Committee.

The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2010/11 Actual £000	2011/12 Original Indicator £000	2011/12 Actual £000
Capital expenditure	24,112	25,500	21,619
Total Capital Financing Requirement:			
• Non-HRA	78,548	83,000	78,855
• HRA	19,171	23,000	21,811
• Total	97,719	106,000	100,666
External debt	102,608	106,000	96,102
Investments*			
• Longer than 1 year	-	-	-
• Under 1 year	34,127	30,000	15,639
• Total	34,127	30,000	15,639

** estimates and actuals, not a prudential indicator*

Other prudential and treasury indicators are to be found in the main body of this report. The Interim s151 Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit), was not breached.

The financial year 2011/12 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened counterparty risk.

RECOMMENDATIONS

The County Council recommended to note the annual treasury management report for 2011/12 together with the prudential indicators for the year which have been scruitinised by the Audit Committee.

Appendices:

Appendix A – Detailed report
Appendix 1 – Summary Portfolio Valuation
Appendix 2 – Public Works Loans Board Rates during the year
Appendix 3 – Economic Conditions

Background papers

Treasury Strategy 2011/12
Prudential Indicators 2011/12

Annual Treasury Management Report 2011/12

1. INTRODUCTION

This report summarises the following functions / activities in financial year 2011/12:

- Capital activity during the year;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Reporting of the required prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

2. THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2011/12

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

- Financed from borrowing; this may be through planned borrowing or otherwise. If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m	2010/11 Actual	2011/12 Estimate	2011/12 Actual
Non-HRA capital expenditure	15	16	13
HRA capital expenditure	9	10	9
Total capital expenditure	**24**	**26**	**22**
Resourced by:			
• Capital receipts	5	3	1
• Capital grants	12	13	10
• Revenue	5	2	4
Unfinanced capital expenditure	**2**	**8**	**7**

3. THE COUNCIL'S OVERALL BORROWING NEED

3.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2011/12 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board (PWLB) or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR

The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

The Council's 2011/12 MRP Policy (as required by WG Guidance) was approved as part of the Treasury Management Strategy Report for 2011/12 on 8 March 2011.

The Council's CFR for the year is shown below, and represents a key prudential indicator. This would include any PFI and leasing schemes on the balance sheet, which would increase the Council's borrowing need, the CFR.

CFR (£m): Council Fund	31 March 2011 Actual	31 March 2012 Budget	31 March 2012 Actual
Opening balance	82.1	83	78.5
Add unfinanced capital expenditure (as above)	-	3	3.6
Less MRP/VRP*	3.6	3	3.3
Closing balance	78.5	83	78.8

CFR (£m): HRA	31 March 2011 Actual	31 March 2012 Budget	31 March 2012 Actual
Opening balance	17.5	20	19.2
Add unfinanced capital expenditure (as above)	2.4	4	3.4
Less MRP/VRP*	0.7	1	0.7
Closing balance	19.2	23	21.9

** Includes voluntary application of capital receipts*

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Net borrowing and the CFR - In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2011/12 plus the expected changes to the CFR over 2012/13 and 2013/14 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2011/12. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2011 Actual (£m)	31 March 2012 Budget (£m)	31 March 2012 Actual (£m)
Gross borrowing position	102.6	106.0	96.1
Net borrowing position	68.5	76.0	80.0
CFR	97.7	106.0	100.7

3.2 As part of the financing of capital expenditure for 2011/12 borrowing was used to finance the gap between available resources (capital receipts, capital grants, capital contributions and revenue contributions), net of contingency, and the capital expenditure. Additionally, given the PWLB rates on offer and the market rates available for investments, it was decided, in the short term at least, to internalise borrowing in order to maximise net income. During the year a loan of £6.5m matured and was not replaced. As a consequence of these strategies the CFR switched from being £4.9m below external borrowing (31 March 2011) to being £4.6m above external borrowing.

3.3 The other debt related indicators are:

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2011/12 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2011/12
Authorised limit	£115.0m
Maximum gross borrowing position	£102.6m
Operational boundary	£110.0m
Average gross borrowing position	£100.5m
Financing costs as a proportion of net revenue stream - CF	5.79%
Financing costs as a proportion of net revenue stream - HRA	14.28%

On balance sheet leasing would also count against authorised limits. A second set of limits was approved, giving scope for £2m leasing. There was no requirement in the year.

4. TREASURY POSITION AS AT 31 MARCH 2012

4.1 The borrowing and investment figures for the council as at the end of the 2011/12 and 2010/11 financial years are as follows:

	31 MARCH 2011			31 MARCH 2012		
Public Works Loans Board – fixed	£000 102,608	Av % 5.31	Av Mat 24.45 yrs	£000 96,103	Av % 5.53	Av Mat 23.87 yrs
Investments (all < 1 year and fixed rate)	25,000	1.28		5,000	1.32	
Deposits (no notice)	9,127	0.81		11,151	0.77	
Net position	68,481			79,952		

These are disclosed in the Council's Statement of Accounts at "fair value": see a more detailed analysis in Appendix 1.

4.2 Borrowing is further broken down by maturity as:

£m	31 MARCH 2011		31 MARCH 2012		Limits	
Total borrowing	102.6	100%	96.1	100%	upper	lower
< 1 year	6.5	6%	0.0	0%	20%	0%
1 – 2 years	0.0	0%	6.5	7%	20%	0%
2 - 5 years	6.5	6%	0.0	0%	50%	0%
5 – 10 years	20.1	20%	20.1	21%	75%	0%
> 10 years	69.5	68%	69.5	72%	100%	0%

4.3 The average borrowing rate of the loan portfolio increased during the year to 5.53% (5.31% 31 March 2011) as the loan that matured was at the low rate of 2.08%. This transaction shortened the average length of the portfolio by just over 6 months.

4.4 Part of the Council's deposits are held in no notice deposit accounts which pay interest at rates near the prevailing base rate (£11.2m at 0.77% (31 March 2011: £9.127m at 0.81%). Of the remaining deposits, £5m was being held for a period of less than 1 year at a rate of 1.32% (31 March 2011: £25m at 1.20% to 1.35%).

5. TREASURY STRATEGY FOR 2011/12

5.1 Our treasury strategy for 2011/12, adopted on the 8 March 2011, was based on the expectation that, in the medium term, investment rates would be short of long term borrowing rates and so value could be best obtained by postponing new external borrowing and adopting internal borrowing. This strategy was subject to caution, with regular monitoring of the interest rate market and a pragmatic approach to changing circumstances so as to avoid long term costs outweighing any short term gains from not externalising.

5.2 The economic position was as outlined in Appendix 3 and PWLB rates were as shown at Appendix 2. These rates favoured the internalisation strategy and so matured debt was not replaced and no debt rescheduling took place.

6. INVESTMENT

6.1 The tight monetary conditions following the 2008 financial crisis continued through 2011/12 with little material movement in the shorter term deposit rates. Bask rate remained at its historical low of 0.5% throughout the year while market expectations of the imminence of the start of monetary tightening was gradually pushed further and further back during the year to the second half of 2013 at the earliest.

Overlaying the relatively poor investment returns were the continued counterparty concerns, most evident in the Euro zone sovereign debt crisis which resulted in a second rescue package for Greece in quarter 1 2012. Concerns extended to the potential fallout on the European banking industry if the crises could have ended with Greece leaving the Euro and defaulting.

6.2 The expected investment strategy was to keep to shorter term deposits (up to 364 days) although the ability to invest out to longer periods was retained. I expected available cash balances of £40m and ranging between £25m and £45m. The budget was set at 1.05% or £420k after adjusting for the higher rates on existing investments. As it turned out, average balances of £37.7m returned £400k. The lower than budgeted average cash balance was the result of internalising the borrowing during the year.

6.3 The investment performance against the benchmark has yet to be measured, with the return to be submitted by mid July. We will report on the outstanding matters later in the year.

7. INVESTMENT SECURITY AND CREDIT QUALITY

7.1 No institutions in which we had made investments had any difficulty in repaying investments and interest on time and in full during the year.

7.2 During 2011/12, credit ratings remained poor across the range of our usual counterparties, including most building societies. Since late 2008 it has become increasingly difficult to place deposits with appropriate counterparties. In December 2008, I obtained the Council's approval to extend flexibility with counterparties to deal with market changes; this included the ability to invest all our surplus funds with central government if necessary. The list was further widened in April 2010 to include nationalised and partly nationalised institutions (and in March 2011 this list was approved, unchanged, for 2011-12). Previous decisions had extended flexibility for investing with local authorities. Our approach of listening to expert advice, taking account of market sentiment and being cautious enabled us to improve credit quality within existing counterparty lists.

7.3 The practical effect of these policies was as follows: during the year we continued to use no notice accounts with major high street institutions (Santander and Bank of Scotland) for day to day cash flow. During December 2011 the credit rating of Clydesdale Bank was downgraded to below the minimum limits and so the funds in that account were withdrawn.

The five fixed term investments (£25.0m) with high quality British institutions in place at the beginning of the year matured during the year. Due to the timing of these maturities and cashflow requirements, three of these investments (£15m) were not re-invested and one (£5m) was re-invested for six months. The new investments were with a nationalised British bank and a UK local authority. It was not necessary to resort to depositing funds with central government.

During March, credit ratings for Santander UK were downgraded bringing the institution below the thresholds in the approved lending list. The Audit Committee on 23 March endorsed the continued use of this institution.

GILL LEWIS
INTERIM HEAD OF FUNCTION (RESOURCES)
& SECTION 151 OFFICER **17 SEPTEMBER 2012**

Atodiad / Appendix 1

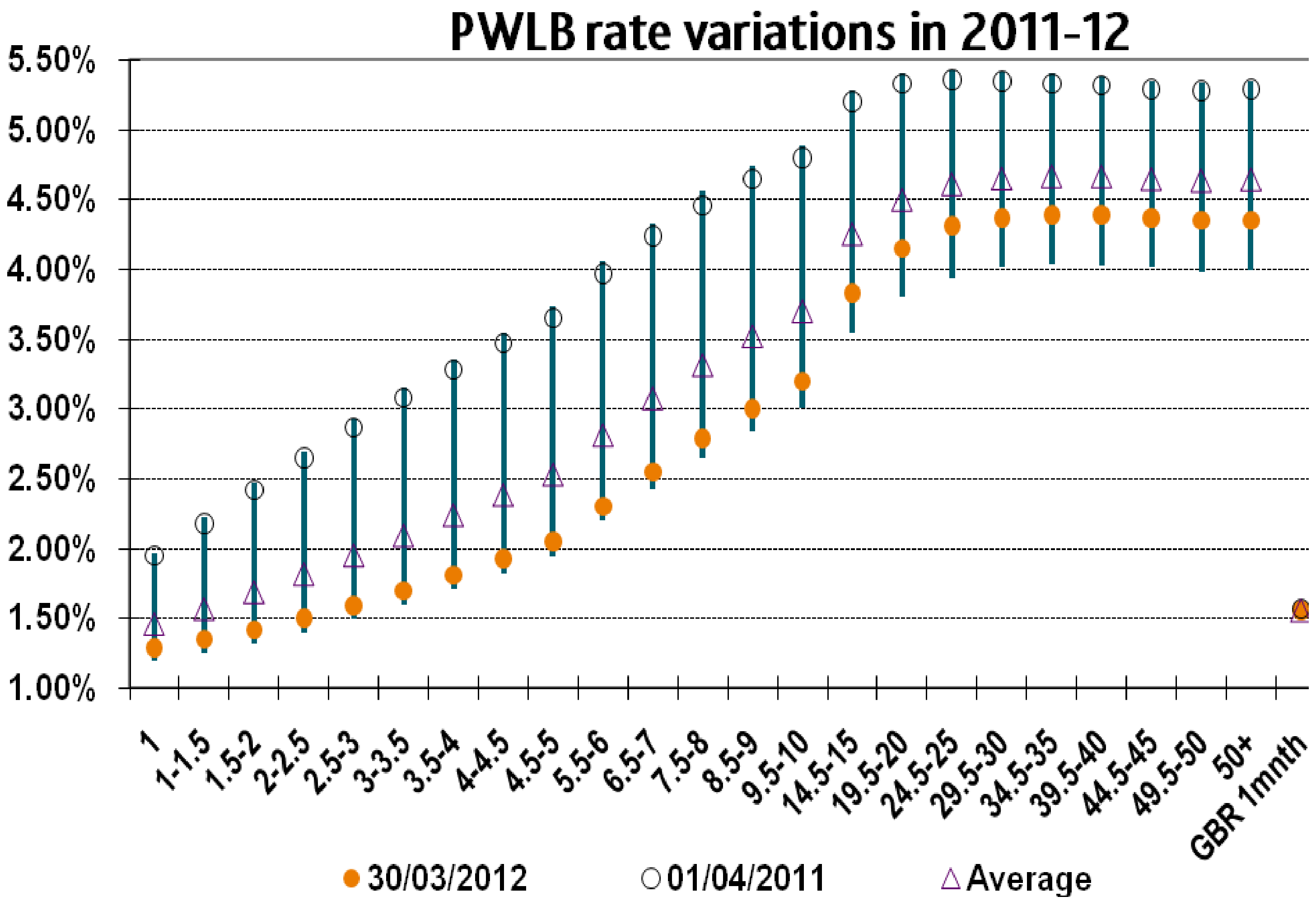
Summary Portfolio Valutaion
As at 31 March 2012

FINANCIAL ASSETS	Nominal / Principal (£)	Fair Value (£)
Cash (interest bearing accounts) (1)	11,151,839	11,209,718
Fixed Term Desposits (2)	5,000,000	5,061,634
FINANCIAL LIABILITIES		
PWLB loan – Maturity	95,815,764	117,338,030
PWLB loan – Annuity	286,858	462,465

Counterparties

(1)	Cash (interest bearing accounts)	
	Santander	9,939,774
	Bank of Scotland	699,065
	HSBC	513,000
(2)	Fixed Term Deposits	
	Royal Bank of Scotland	5,000,000

Atodiad / Appendix 2



Atodiad / Appendix 3

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2011/12 was the year when financial markets were apprehensive, fearful of the potential of another Lehman's type financial crisis if there was a precipitous Greek Government debt default. The European Central Bank (ECB) eventually calmed market concerns of a liquidity crisis among European Union (EU) banks by making available two large three year credit lines, totalling close to €1 trillion at 1%. This also provided a major incentive for those same banks to then use this new liquidity to buy EU sovereign debt yielding considerably more than 1%.

A secondary benefit of this initiative was the bringing down of sovereign debt yields, for the likes of Italy and Spain, below unsustainable levels. The final aspects in the calming of the EU sovereign debt crisis were two eleventh hour agreements: one by the Greek Government of another major austerity package and the second, by private creditors, of a "haircut" (discount) on the value of Greek debt that they held, resulting in a major reduction in the total outstanding level of Greek debt. These agreements were a prerequisite for a second EU / IMF bailout package for Greece which was signed off in March.

Despite this second bailout, major concerns remain that these measures were merely a postponement of the debt crisis, rather than a solution, as they did not address the problem of low growth and loss of competitiveness in not only Greece, but also in other EU countries with major debt imbalances. These problems will, in turn, also affect the financial strength of many already weakened EU banks during the expected economic downturn in the EU. There are also major questions as to whether the Greek Government will be able to deliver on its promises of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population. In addition, an impending general election in May 2012 will deliver a democratic verdict on the way that Greece is being governed under intense austerity pressure from the northern EU states.

The UK coalition Government maintained its tight fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA credit rating. Key to retaining this rating will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within the austerity plan timeframe. The USA and France lost their AAA credit ratings from one rating agency during the year.

UK growth proved mixed over the year. In quarter 2, GDP growth was zero, but then quarter 3 surprised with a return to robust growth of 0.6% q/q before moving back into negative territory (-0.3%) in quarter 4. The year finished with prospects for the UK economy being decidedly downbeat due to a return to negative growth in the EU in quarter 4, our largest trading partner, and a sharp increase in world oil prices caused by Middle East concerns. However, there was also a return of some economic optimism for growth outside the EU and dovish comments from the major western central banks: the Fed in America may even be considering a third dose of quantitative easing to boost growth.

UK CPI inflation started the year at 4.5% and peaked at 5.2% in September. The fall out of the January 2011 VAT increase from the annual CPI figure in January 2012 helped to bring inflation down to 3.6%, finishing at 3.5% in March. Inflation is forecast to be on a downward trend to below 2% over the next year.

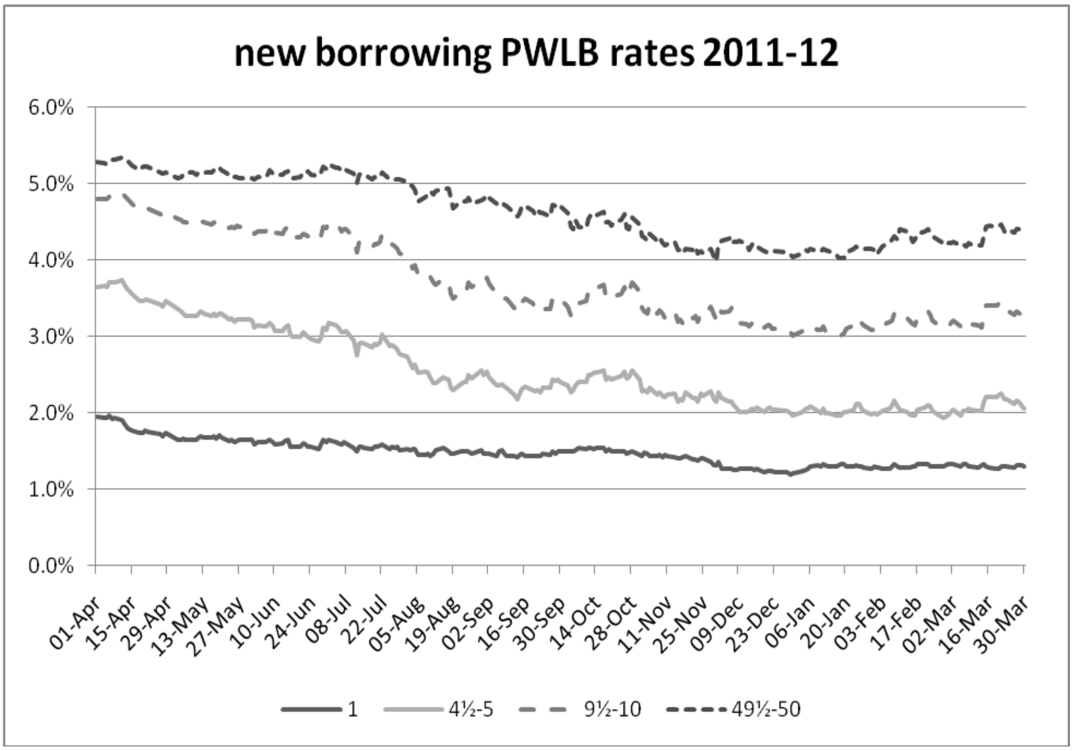
The Monetary Policy Committee agreed an increase in quantitative easing (QE) of £75bn in October on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. The MPC then agreed another round of £50bn of QE in February 2012 to counter the negative impact of the EU debt and growth crisis on the UK.

Gilt yields fell for much of the year, until February, as concerns continued building over the EU debt crisis. This resulted in safe haven flows into UK gilts which, together with the two UK packages of QE during the year, combined to depress PWLB rates to historically low levels.

Bank Rate was unchanged at 0.5% throughout the year while expectations of when the first increase would occur were steadily pushed back until the second half of 2013 at the earliest. Deposit rates picked up in the second half of the year as competition for cash increased among banks.

Risk premiums were also a constant factor in raising money market deposit rates for periods longer than 1 month. Widespread and multiple downgrades of the credit ratings of many banks and sovereigns, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment.

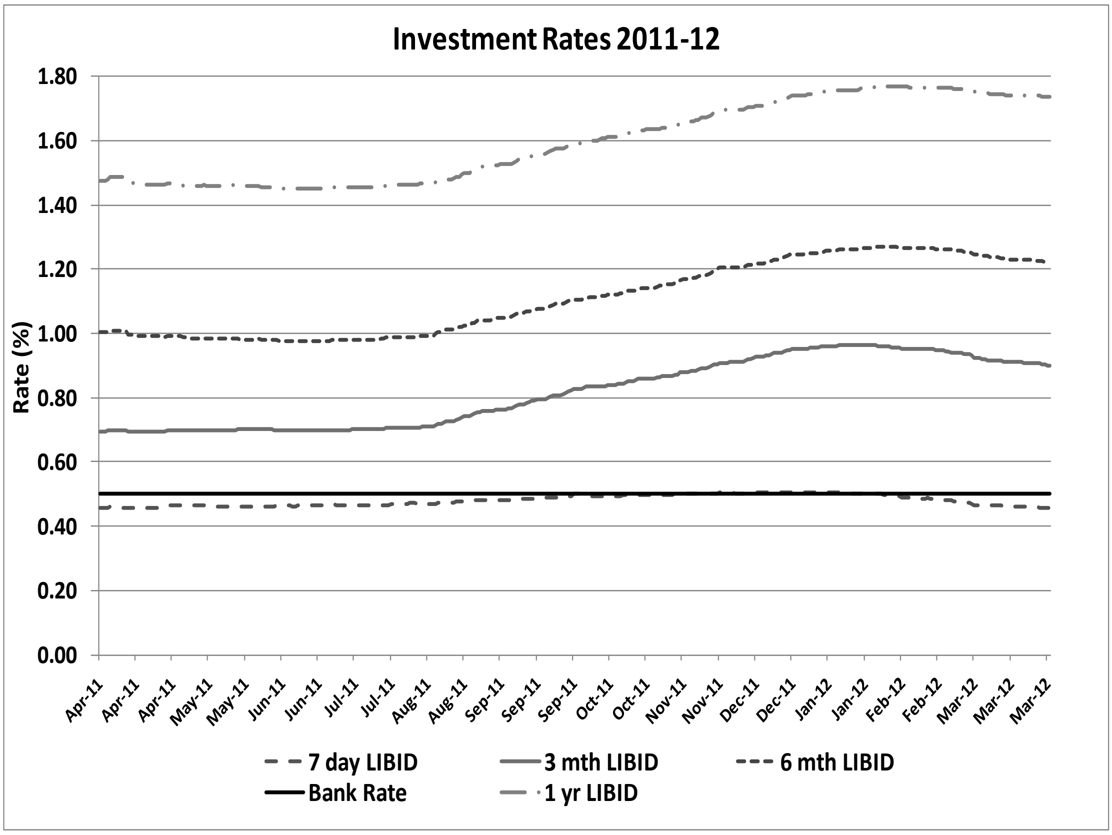
Chart 1: Borrowing Rates 2011-12



Darn o adroddiad gan SECTOR, Ymgynghorwyr Rheoli Trysorlys

Extract from report by SECTOR, Treasury Management Consultants

Chart 2: Investment Rates 2011-12



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Extract from report by SECTOR, Treasury Management Cons