# AUDIT, PENSIONS AND STANDARDS COMMITTEE

**27 SEPTEMBER 2012**

| **CONTRIBUTORS** | **TREASURY MANAGEMENT OUTTURN 2011-12** | **Wards** |
|---|---|---|
| DCFG | This report provides information on the Council's debt, borrowing and investment activity for the financial year ending 31st March 2012 | All |

**<u>RECOMMENDATIONS:</u>**

1) To note that the Council has not undertaken any borrowing for the period 1st April 2011 to 31st March 2012.

2) To note the investment activity for the period 1st April 2011 to 31st March 2012.

## 1. INTRODUCTION AND BACKGROUND

1.1 This report presents the Council's Annual Treasury Report for 2011/12 in accordance with the Council's treasury management practices. It is a regulatory requirement for this outturn report to be presented to the Committee by 30th September each year.

1.2 There are two aspects of Treasury performance – debt management and cash investments. Debt management relates to the Council's borrowing and cash investments to the investment of surplus cash balances. This report covers:

- The treasury position as at 31st March 2012
- The UK economy and interest rates
- Investment strategy and outturn for 2011/12
- The borrowing strategy and outturn for 2011/12
- Compliance with treasury limits and prudential indicators

1.3 The borrowing amounts outstanding and cash investment for the relevant periods are as follows:

Table 1 – Balances

| | 31/03/12 | 31/03/11 | 31/03/10 |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| Total borrowing | 262,166 | 475,520 | 475,520 |
| Total cash balances | 109,300 | 70,000 | 137,000 |

## 2. TREASURY POSITION AS AT 31st MARCH 2012

2.1 **Investments**
The table below provides a breakdown of the cash deposits, together with comparisons from the previous year.

Table 2 – Investments

| Investment Type | **31 March 2012** | **31 March 2011** |
|---|---|---|
| | **£000's** | **£000's** |
| Call Account | 18,800 | 30,000 |
| Term Deposits | 69,500 | 10,400 |
| Money Market Funds | 21,000 | 30,000 |
| **Total** | **109,300** | **70,400** |

2.2 The Council had invested in four money markets funds during 2011-12 Prime Rate, Goldman Sachs, Insight and Blackrock producing returns ranging from 0.55 to 0.96%, all are AAA rated.

2.3 The term deposits ranged from overnight to 1 year. The weighted average interest rate of return on the investments over the year was 1.18%.

## 3. BORROWING

3.1 Treasury Borrowing

No new borrowing was undertaken during the year. PWLB debt maturing during the year, which was not refinanced, totalled £16 million, with an average nominal interest rate of 9.84%. This resulted in a reduction in the average PWLB borrowing rate from 5.70% to 5.61%.

3.2 An analysis of movements on loans during the period is shown below:

Table 3 – Movement on loans

| | Balance 31.03.11 £000s | Loans/Invs Raised £000s | Loans/Invs Repaid £000s | Balance 31.03.12 £000s |
|---|---|---|---|---|
| PWLB | 475,520 | 0 | (16,000) | |
| PWLB HRA settlement | | | (197,354) | |
| Total debt | 475,520 | 0 | (213,354) | 262,166 |

Table 4 – Outstanding Debt

| | 31 March 2011 | | 31 March 2012 | |
|---|---|---|---|---|
| | Principal | Average Rate | Principal | Average Rate |
| | £000's | | £000's | |
| PWLB General Fund | 60,993 | | 44,785 | |
| PWLB HRA | 414,527 | | 217,381 | |
| Total | 475,520 | 5.70% | 262,166 | 5.61% |

3.3 The implementation of housing finance reform at the end of the year abolished the housing subsidy system financed by central government and consequently all housing debt has been reallocated nationally between housing authorities. The result of this reallocation is that this Council received, at the end of the year, a repayment of debt by the Department of Communities and Local Government of £197.35 million (which resulted in a corresponding decrease in its HRA CFR). The CLG has also paid the premium (breakage costs) of £53.99 million.

Table 5 – Capital Financing Requirement (CFR)

| | 31 March 2011 Actual £'000 | 31 March 2012 Budget £'000 | 31 March 2012 Actual £'000 |
|---|---|---|---|
| CFR General Fund | 121,768 | 111,679 | 99,684 |
| CFR HRA | 414,527 | 217,427 | 217,381 |
| Total CFR | 536,295 | 329,106 | 317,065 |

3.4 The CFR represents the underlying borrowing need of the HRA and General Fund. The reason why actual borrowing is lower than the CFR is because the Council has effectively borrowed from its internal resources.

## 4. THE ECONOMY AND INTEREST RATES

4.1 **Sovereign debt crisis.** 2011-12 was the year when financial markets were apprehensive, fearful of the potential of another Lehman's type financial crisis, prompted by a precipitous Greek Government debt default. At almost the last hour, the European Central Bank (ECB) calmed market concerns of a liquidity crisis among European Union (EU) banks by making available two huge 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%.

4.2 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.

4.3 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 new 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.

4.4 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 ratings from one rating agency during the year.

4.5 **UK growth** proved mixed over the year. In quarter 2, GDP growth was zero, from the major western central banks: the US economy was flat 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 a third dose of quantitative easing to boost growth.

4.6 **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.

4.7 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.

4.8 **Gilt yields** fell with the **Bank Rate** unchanged at 0.5% throughout the year. 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.

4.9 **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.

## 5. INVESTMENT STRATEGY AND OUTTURN FOR 2011/12

5.1 The investment strategy for 2011/12 was to place cash investments with certain institutions as set out in the Treasury Management Strategy, to focus on the security and liquidity of the investments rather than to seek yield. Where security and liquidity criteria could be satisfied, investments would then be placed taking yield into account.

5.2 The investments outstanding at 31st March 2012 amounted to £109.3 million: £18.8 million was invested in NatWest Call Account, £21 million invested in 3 money Market Funds, £10 million with a Local Authority and £59.5 million invested in short term deposits.

Table 3 – Investment Portfolio as at 31st March 2012

| **Deposit** | **Counterparty** | **£'000** |
|---|---|---|
| Call Account | NatWest | 18,800 |
| Money Market Funds | Goldman Sachs | 1,000 |
| | Insight | 10,000 |
| | Primerate | 10,000 |
| Term Deposits | DMADF | 4,500 |
| | LloydsTSB | 35,000 |
| | NatWest | 15,000 |
| | Birmingham City Council | 10,000 |
| | Barclays Bank | 5,000 |

5.3 Interest earnings for 2011/12 were £1.20 million compared to £1.19 million for 2010/11.

5.4 An analysis of movements on investments during 2011/12 is shown below.

Table 6 – Movement on Investments

| | Balance 31.03.11 £000s | Loans/Invs Raised £000s | Loans/Invs Repaid £000s | Balance 31.03.12 £000s |
|---|---|---|---|---|
| Investments | 70,400 | 1,021,600 | (982,700) | 109,300 |

## 6. BORROWING STRATEGY AND OUTTURN 2011/12

6.1 The treasury strategy for 2011-12, approved by the Council on 28th February 2011, was based on the expectation that base rate, whilst remaining low, would rise gradually from the fourth quarter of 2011 with similar gradual rises in medium and longer term fixed interest rates over 2011-12. Continued uncertainty in the aftermath of the 2008 financial crisis led to a continuation of a cautious approach for investments with low counterparty risk the main consideration, resulting in relatively low returns compared to borrowing rates.

6.2 Due to the level of cash balances held by the Council of £70.4 million at 31st March 2011, it was anticipated that there would not be any need to borrow during 2011/12.

6.3 An analysis of the Council's long term (PWLB) borrowings by maturity (i.e. date of repayment) is as follows:

Table 7 – PWLB Debt by maturity

| PWLB | 31 March 2011 £000s | 31 March 2012 £000s |
|---|---|---|
| Up to One year | 16,000 | 100 |
| One to two years | 175 | 11,556 |
| Between two and five years | 52,881 | 18,614 |
| Between five and ten years | 70,400 | 40,164 |
| More than ten years | 336,064 | 191,732 |
| Total | 475,520 | 262,166 |

## 7. COMPLIANCE WITH TREASURY LIMITS AND PRUDENTIAL INDICATORS

During the financial year the Council operated within its treasury limits and Prudential Indicators as set out in the Council's Treasury Strategy Report.

Table 8 – Authorised Limit and Operational Boundary 11/12

| **External debt indicator** | **Approved limit (£m)** | **Actual borrowing** | **Days exceeded** |
|---|---|---|---|
| Authorised limit[1] | 364 | | |
| Operational boundary[2] | 303 | 262 | None |

[1] Authorised limit for external debt is the limit above which external debt must not go without changing Council Policy

[2] Operational boundary for external debt is the limit against which external debt will be constantly monitored.

Table 9 – Maturity Structure of Borrowing

| Maturity structure of borrowing | Lower Limits (%) | Upper Limits (%) | Actual at 31st March 2012 (%) |
|---|---|---|---|
| Under 12 months | 0 | 15 | 0.04 |
| 1-2 years | 0 | 15 | 4.41 |
| 2-5 years | 0 | 60 | 9.80 |
| 5-10 years | 0 | 75 | 12.62 |
| 10 years and over | 0 | 100 | 73.13 |

Table 10 – Limits on interest rate exposure

| Upper limits on interest rate exposure | Approved maximum limit | Actuals as at 31st March 2012 |
|---|---|---|
| **Debt** | | |
| Fixed interest rate exposures | 330,000 | 262,166 |
| Variable interest rate exposures | 66,000 | 0 |

## 8. Comments of the Executive Director of Finance and Corporate Governance

The comments of the Executive Director of Finance and Corporate Governance are contained within this report.

## 9. Comments of the Director of Legal and Democratic Services

There are no direct legal implications for the purpose of this report.

## 10. Recommendations

To note the borrowing and investment activity for the period 1st April 2011 to 31st March 2012.

**LOCAL GOVERNMENT ACT 2000 - BACKGROUND PAPERS**

| No. | Brief Description of Background Papers | Name/Ext. of holder of file/copy | Department/Location |
|---|---|---|---|
| 1. | Loans and Investments Ledger | Rosie Watson Ext: 2563 | Westminster City Hall, Treasury and Pensions Team 16th Floor |
| 2. | CIPFA Treasury Management Code of Practice | Rosie Watson Ext: 2563 | Westminster City Hall, Treasury and Pensions Team, 16thFloor |