BRENT COUNCIL	**Full Council** 19 November 2012 **Report from the Deputy Director of Finance**

For Action	Wards Affected: ALL

The Treasury Management Annual Report 2011/12

1. SUMMARY

The purpose of this report is to summarise borrowing and investment activity and performance compared to prudential indicators during 2011/12. The Executive has recommended this report to Full Council for approval. The report has also been considered by the Audit Committee meeting of 27 September 2012 as part of the scrutiny function required under the 2009 Treasury Management Code of Practice issued by CIPFA.

The Executive, at its meeting on 19 September 2012, resolved to submit the recommendations in the report to Full Council without any further comments.

2. RECOMMENDATIONS

That Full Council:

2.1 Approves the Treasury Management Annual Report (section 3); and Annual Investment Strategy Report (section 4)

2.2 Notes the outturn for prudential indicators (section 5)

2.3 Notes the updated position since 2011/12 (paras.3.15 – 3.16).

3. TREASURY MANAGEMENT ANNUAL REPORT

3.1 Full Council adopted the 2009 CIPFA Code of Practice on Treasury Management in Local Authorities in September 2010. The Code stipulates that the Chief Financial Officer should set out in advance to Full Council the treasury strategy for the forthcoming financial year, issue a progress report during the year and subsequently report treasury management activities at the year-end. This section of the report details:-

a) The economic background for 2011/12 (paras 3.3 to 3.4)

b) The agreed treasury strategy (para 3.5)

c) Borrowing activity during 2011/12 (paras 3.6 to 3.8)

d) Lending activity during 2011/12 (paras 3.9 to 3.13)

e) Overall interest paid and received (para 3.14)

f) Developments since the year end (paras 3.15 – 3.16)

3.2 Treasury management in this context is defined as 'the management of the local authority's cash flows, banking, money market (short term borrowing and lending) and capital market (long term borrowing) transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.' This means that the pursuit of additional returns must be secondary to protecting the Council's cash balances and a rigorous assessment of risk.

ECONOMIC BACKGROUND FOR 2011/12

3.3 The world economy grew by 3.6% in 2011. The UK economy grew by 0.7%, USA by 1.7%, the Euro area by 0.7% (though Germany grew by 1.5%) and the Chinese economy slowed to 8.9%. In the UK growth remained slow as banks were unable or unwilling to lend and borrowers were unwilling to increase existing debts. In the USA, quantitative easing (governments buying back debt and increasing the money supply) supported activity and reduced longer term interest rates. In the UK, inflation as measured by the Consumer Price Index remained above 3% as VAT increases and some price rises (such as energy) passed through the system. The Bank Base Rate remained at 0.5% as monetary policy sought to encourage economic growth given an assumption that inflation would fall to reflect low economic activity. Overnight interest rates remained very low, at 0.3% - 0.4%. Fiscal policy has become progressively tighter in 2011/12, a trend which is likely to continue. Markets experienced continued volatility as Euro-zone authorities failed to change the widely held perception that they were unable to bringing the situation under control; it became steadily clearer that Greece would continue to experience difficulty in remaining in the Euro-zone and speculation mounted that other countries would also be forced to review their membership

3.4 Table 1 shows interest rates charged during the year by the Public Works Loans Board (PWLB), the government agency that provides long term credit to local authorities. Previously, the PWLB enabled local authorities to borrow at similar rates to the government (gilt yield plus 0.15%). However, in October 2010 it was decided that local authorities would pay rates set at the gilt rate plus 1% in order to encourage local authorities to reassess the viability of capital projects and use their cash balances to finance them where appropriate. It can be seen that rates fell during the year, reflecting the low demand for credit and desire for security and rates are now similar to those which prevailed under the old charging regime.

Table 1 – PWLB Interest rates during 2011/12

	1 April 2011 %	**30 June %**	**30 Sept. %**	**31 March 2012 %**
10 year	4.80	4.42	3.47	3.30
25 year	5.36	5.22	4.53	4.32
50 year	5.28	5.18	4.69	4.36

STRATEGY AGREED FOR 2011/12

3.5 On the basis of advice and research from the Council's treasury adviser, Arlingclose, Capital Economics and pension fund managers, it was anticipated that the bank rate would remain unchanged throughout 2011/12. It was agreed as part of the strategy that lending that lending would be kept short (less than one year), that long term loans would be allowed to mature, and that the lending list would be expanded when market conditions allowed. It was also agreed that borrowing would remain flexible, but that the Council would take short term or variable debt if it was likely that rates would stay low. It was also agreed that officers would look for opportunities to restructure debt, recognising that low rates might make this uneconomic.

BORROWING ACTIVITY DURING 2011/12

3.6 The split of the Council's treasury portfolio between fixed interest and variable loans and investments, is set out in Table 2.

Table 2 – Treasury portfolio at 31 March – loans and investments

	Actual		**Interest rate**
	31/03/11 £m	**31/03/2012 £m**	**31/03/2012 %**
Fixed rate loans – PWLB	491.0	310.0	4.84
Variable rate loans – PWLB	-	-	
Variable rate loans – Market	95.5	95.5	4.31
Short-term loans – Market	69.2	26.3	0.39
GROSS DEBT	**655.7**	**431.8**	**4.47**
Investments	57.5	43.8	0.38
NET DEBT	**598.2**	**388.0**	

3.7 The average rate of interest payable by the Council on its loans has risen slightly from 4.37% in 2010/11 to 4.47% in 2011/12, mainly because of a reduced proportion of temporary debt in the portfolio. No debt restructuring was undertaken during the year but, at the end of March, the Department for Communities and Local Government repaid £198m of PWLB debt relating to the Housing Revenue Account (HRA). The intention is that this will place the HRA in a position where it can be self-financing in the long term with the interest saved accruing to the HRA. It is intended that the remaining debt will be apportioned between the HRA and the General Fund on a basis which is equitable and allows the HRA to plan its business with some degree of certainty about its costs. In 2011/12, the Council borrowed £20m from the PWLB on Equal Instalment of Principal (EIP) terms at 2.34%, repayable over 10 years.

3.8 The duration and average interest rate of loans in the treasury portfolio is set out in Table 3.

Table 3 – Treasury portfolio at 31 March 2012 – duration/interest rates

Maturing Within	£m		Share of total debt %	Average Interest Rate 31/03/12 %
	31/03/11	31/03/12		
1 Year	71.2	28.7	6.6	0.58
1 – 5 Years	8.0	9.8	2.3	2.64
6 - 10 years	19.0	18.9	4.4	3.92
11 – 20 years	5.0	0	-	0.00
21 – 30 years	30.0	18.3	4.2	4.75
31 – 40 years	85.0	61.9	14.4	4.60
Over 40 years	342.0	198.7	46.0	5.38
Market (all over 40 years)	95.5	95.5	22.1	4.72
TOTAL	**655.7**	**431.8**	**100.0**	**4.45**

LENDING ACTIVITY DURING 2011/12

3.9 The Council's investments averaged £49m during 2011/12 (£78m during 2010/11) and earned interest of £0.3m. The portfolio of long term deposits (deposited in 2008 for up to three years) finally matured, and new deposits have been for less than one month at rates generally between 0.25% and 0.75%. The amount invested has varied from day to day depending on cash-flow and the Council's borrowing activity.

3.10 Investments by the in-house team were made primarily with the intentions of achieving security and liquidity placed with AAA rated Money Market Funds or for periods up to one month. Rates achieved generally ranged between 0.25%

and 0.75%, with an average rate achieved of 0.6% (2010/11, 1.3%). Loans were made to high quality counterparties included on the Treasury Lending List. Appendix 1 lists the deposits outstanding at 31 March 2012.

3.11 Brent still has deposits in two Icelandic banks which were placed into receivership following the collapse of Lehman Brothers in 2008. The original deals were:-

Heritable	£10m	5.85%	Lent 15/08/08	Due back 14/11/08
Glitnir	£5m	5.85%	Lent 15/09/08	Due back 12/12/08

3.12 The Council continues to work with the Local Government Association and other authorities to recover the loans to Icelandic banks. Local authorities were accepted as preferred creditors of Glitnir in the Icelandic Courts and this resulted in almost the whole sum deposited being repaid. The final recovery remains slightly uncertain as about £1m remains denominated in Icelandic krone and held in a ring-fenced account in Iceland, pending conversion and repayment by the Central Bank of Iceland. The administrators for Heritable have repaid £1.8m in 2011/12, and a further £0.4m to date in 2011/12. The administrators have indicated that creditors should expect to receive between 86%-90% of deposits plus interest to October 2008, in instalments to 2013.

3.13 External cash managers were initially appointed in 1998 to manage two portfolios with the aim of achieving an improved return at an acceptable level of risk. Aberdeen Asset Management's £23.7m portfolio was liquidated in July 2011 because the opportunities for additional yield no longer compensated for the costs of maintaining the arrangement.

TOTAL INTEREST PAID AND RECEIVED

3.14 Total interest paid and received in 2011/12 is shown in Table 4. The reduced interest paid on external debt reflects the restructuring in October 2010 and short term borrowing at lower rates.

Table 4 – Overall interest paid and received in 2011/12

	Budget £m	**Actual £m**
Interest paid on external debt	32.2	28.6
Interest received on deposits	0.1	0.3
Debt management expenses	0.4	0.4

DEVELOPMENTS SINCE THE END OF THE YEAR

3.15 UK financial markets have been volatile since the end of the financial year, mainly in response to continued worries about credit worthiness and debt owed by Portugal, Ireland, Italy, Greece and Spain. Short term interest rates remain very low and long term rates have fallen in response to lenders seeking safer investments for cash and the growing belief that economic recovery will be very slow and monetary conditions will continue to be loosened. In consultation with Arlingclose, the Council has borrowed £20m from the PWLB; £10m for ten years at 1.99% and £10m for twenty years at 2.64% towards meeting the long term financing requirement for the new Civic Centre (both on EIP terms).

3.16 In response to continuing fears about developments in Euro-zone markets, Arlingclose issued advice in May that local authorities should restrict lending to less than 1 month for UK banks and overnight for Santander, before subsequently removing Santander completely. The Council has used slightly tighter criteria than Arlingclose and, in practice, Brent no longer lends to UK banks, and all maturities are currently kept very short. Though a number of Australian and Canadian banks are on the list, and have occasionally been useful, most lending is to AAA rated Money Market Funds (MMFs) and the UK Debt Management Office, an arm of the Bank of England.

4 ANNUAL INVESTMENT STRATEGY REPORT

4.1 Regulations issued under the 2003 Local Government Act require that councils agree an Annual Investment Strategy (AIS) before the beginning of each year, setting out how investments will be prudently managed with close attention to security and liquidity. The AIS for 2011/12 was agreed by Full Council in March 2011. The AIS sets out the security of investments used by the authority analysed between Specified (offering high security and liquidity, with a maturity of no more than one year) and Non-Specified (entailing more risk or complexity, such as gilts, certificates of deposit or commercial paper) investments. The AIS also sets out the maximum duration of deposits.

4.2 Treasury activity has fully complied with the AIS in 2011/12. The approach has been to lend for short periods to high quality counterparties, reducing risk. As loans have matured, receipts have been used to minimise borrowing.

5. PRUDENTIAL INDICATORS – 2011/12 OUTTURN

5.1 The introduction of the prudential system of borrowing in the 2003 Local Government Act (LGA) gave opportunities for councils to assess their requirements for capital spending and not have them restricted by nationally set approvals to borrow money (credit approvals) as previously. The prudential system also brought new responsibilities on councils to ensure that:

a) capital expenditure plans are affordable;

b) all external borrowing and other long term liabilities are within prudent and sustainable levels;

c) treasury management decisions are taken in accordance with good professional practice.

5.2 Under regulations issued under the 2003 LGA councils are required to follow the Prudential Code issued by CIPFA which sets out how councils ensure responsible use of these freedoms. The Code details indicators that councils are required to set before the beginning of each year, to monitor during the year and to report on at the end of each year.

5.3 The outturn for prudential indicators measuring affordability is set out in Table 5. General Fund and HRA capital financing charges as a proportion of total budget were lower than the original estimates as a result of the reduced requirement to fund expenditure from unsupported borrowing in 2011/12.

Table 5 – Prudential indicators measuring affordability

	2011/12 (estimates)	**2011/12 (actual)**
Capital financing charges as a proportion of net revenue stream: - General Fund	9.3%	7.7%
- HRA	36.4%	35.7%
Impact of unsupported borrowing on: - Council tax at Band D	£4.68	£2.42
- Weekly rent	-	-

5.4 The outturn for prudential indicators for capital spending is set out in Table 6. Movements within the capital programme, including slippage between years and resources becoming available during the year, are to be reported in the Performance and Finance Quarter 4 Outturn report to the Executive in July 2012. Capital spending is funded from a variety of resources, including government grants, capital receipts, revenue contributions, Section 106 contributions and borrowing. This means that movements in capital spending are not directly reflected in movements in the Capital Financing Requirement (CFR), which principally reflects borrowing requirements.

Table 6 – Prudential indicators measuring capital spending and CFR

	2011/12 Estimates £m	**2011/12 Actual £m**
Planned capital spending: - General Fund	133.4	99.7
- HRA	20.1	14.5
- **TOTAL**	**153.5**	**114.2**
Estimated capital financing requirement for: - General Fund	371.5	350.5
- HRA	337.7	331.3
- **TOTAL**	**709.2**	**681.8**

5.5 The Council also sets prudential indicators for external debt as shown in Table 7. This is to ensure that the Council's overall borrowing is kept within prudent limits. The Authorised Limit for external borrowing is set flexibly above the CFR to allow for opportunities to restructure debt or borrow early when interest rates are favourable. The Operational Boundary sets out the expected maximum borrowing during the year, allowing for cash flow, interest rate opportunities and restructuring.

Table 7 – Prudential indicators for external debt

Indicator	Limit	Status
Authorised limit for external debt	£850m	Met
Operational boundary for external debt	£750m	Met
Net borrowing	Below CFR	Met

5.6 The prudential indicators for treasury management, which are included in Table 8 below, were all met. These are set to ensure that interest rate exposures are managed to avoid financial difficulties if interest rates rise sharply. Although borrowing at variable rates can be advantageous if rates are falling, a sharp rise can cause budget difficulties, and force the Council to fix rates at an inopportune time. Managing loan durations ensures a variety of maturity dates to avoid a disproportionate amount of re-financing when rates may be high. Finally, the upper limit on investments of more than one year allows flexibility to lend for longer periods if interest rates make this advantageous, particularly by external managers investing in gilts, but also ensures that a minimum level of balances is available for cash flow purposes. Deposits have been short term, and long term loans have been run down during the year.

Table 8 – Prudential indicators for treasury management

Indicator	Limit	Outcome
Treasury Management Code		Adopted
Exposure to interest rate changes		
- fixed rate upper limit	100%	98%
- variable rate upper limit	40%	19%
Maturity of fixed interest loans		
Under 12 months		
- upper limit	40%	1%
- lower limit	0%	0%
12 months – 24 months		
- upper limit	20%	1%
- lower limit	0%	0%
24 months – 5 years		
- upper limit	20%	1%
- lower limit	0%	0%
5 years – 10 years		
- upper limit	60%	2%

- lower limit	0%	0%
Above 10 years		
- upper limit	100%	98%
- lower limit	30%	96%
Upper limit on investments of more than one year	**£60m**	**£22m**

6. MINIMUM REVENUE PROVISION

6.1 The Local Authorities (Capital Finance and Accounting) Regulations 2003 as revised in 2008 require an authority to set an amount of Minimum Revenue Provision which is considered to be 'prudent'. The definition of what counts as 'prudent' is set out in statutory guidance which has been issued by the Secretary of State for Communities and Local Government and which authorities must 'have regard' to.

6.2 Under the guidance councils are required to prepare an annual statement of their policy on making Minimum Revenue Provision to Full Council. The purpose of this is to give Members the opportunity to scrutinise the use of the additional freedoms and flexibilities under the new arrangements. This Policy Statement was submitted and approved by the Full Council at its meeting in March 2012 within section 9 of the Budget Setting report.

7. FINANCIAL IMPLICATIONS

7.1 Financial implications are set out within this report.

8. DIVERSITY IMPLICATIONS

8.1 The proposals in this report have been subject to screening and officers believe that there are no diversity implications arising from it.

9. LEGAL IMPLICATIONS

9.1 Guidance has been issued under Section 21 (IA) of the Local Government Act 2003 (the '2003 Act') on how to determine the level of prudent provision. Authorities are required by Section 21 (B) to have regard to this guidance.

9.2 Under regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) authorities have significant discretion in determining their Minimum Revenue Provision but, as a safeguard, the guidance issued under the 2003 Act recommends the formulation of a plan or strategy which should be considered by the whole Council. This mirrors the existing requirement to report to Council on the prudential borrowing limit and investment policy. The Local Authorities (Functions and Responsibilities) (England) (Amendment) Regulations 2000 have been amended to reflect that the formulation of such a plan or strategy should not be the sole responsibility of the Executive.

10. BACKGROUND INFORMATION

1. Logitech Loans Management System.
2. Arlingclose reports on treasury management.
3. Aberdeen Asset Management quarterly reports.
4. 2011/12 Budget and Council Tax report – March 2011

11. CONTACT OFFICERS

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APPENDIX 1

Brent treasury lending list

The current investments outstanding as at 31 March 2012 were:

Name	**Amount £m**	**Yield %**	**Lending Date**	**Maturity Date**
Global Treasury Fund (RBS)	8.0	0.59	Call	
Gartmore Cash Reserve	2.0	0.60	Call	
Northern Trust Global Fund	0.1	0.15	Call	
Heritable bank	3.2	5.85	15/08/08	14/11/08
Glitnir	1.0	5.85	15/09/08	12/12/08
Isle of Wight Council	5.0	0.30	30/03/12	05/04/12
London Borough of Merton	5.0	0.30	30/03/12	02/04/12
Santander UK plc	10.0	0.52	30/03/12	03/04/12
UK Debt Management Fund	9.5	0.25	30/03/12	03/04/12
Total	**43.8**			