CHESHIRE EAST COUNCIL

CABINET

Date of Meeting: 1 August 2011
Report of: Borough Treasurer and Head of Assets
Subject/Title: Treasury Management Annual Report 2010-11
Portfolio Holder: Cllr Wesley Fitzgerald

1.0 Report Summary

1.1 The Treasury Management Policy requires an annual report on the performance of the Council's treasury management operation. This report contains details of the activities in 2010-11 for Cheshire East Borough Council.

2.0 Decision Requested

2.1 To receive the Treasury Management Annual Report for 2010-11 as detailed in Appendix A.

3.0 Reasons for Recommendations

3.1 To meet the requirements of the CIPFA Code of Practice for Treasury Management in the Public Services and the Prudential Code for Capital Finance in Local Authorities.

4.0 Wards Affected

4.1 Not applicable

5.0 Local Ward Members

5.1 Not applicable

6.0 Policy Implications including – Carbon Reduction
- Health

6.1 None

7.0 Financial Implications (Authorised by the Borough Treasurer)

7.1 Contained within the report.

8.0 Legal Implications (Authorised by the Borough Solicitor)

8.1 There are no specific legal implications related to the issues raised in this report.

9.0 Risk Management

9.1 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management function will be measured.

10.0 Background and Options

10.1 This annual treasury report, detailed in Appendix A covers:

- the Councils treasury year end position;
- forecast prospects for interest rates for 2010/2011;
- interest rate outturn for 2010/2011;
- compliance with treasury limits;
- investment strategy for 2010/2011;
- borrowing strategy for 2010/2011;
- economic events of 2010/2011;
- Prudential indicators 2010/2011.

11.0 *Access to Information*

The background papers relating to this report can be inspected by contacting the report writer:

Name:	Lisa Quinn
Designation:	Borough Treasurer and Head of Assets
Tel No:	01270 686628
Email:	lisa.quinn@cheshireeast.gov.uk

Appendix A

Treasury Management Annual Report 2010/11

Introduction and Background

The CIPFA definition of Treasury Management is *"the management of the Council's investments and 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"*.

The Treasury Management Code requires public sector authorities to determine an annual Treasury Management Strategy and now, as a minimum, formally report on their treasury activities and arrangements to full Council mid-year and after the year-end. 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/governance of the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.

This report:

a) is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;
b) presents details of capital financing, borrowing, debt rescheduling and investment transactions;
c) reports on the risk implications of treasury decisions and transactions;
d) gives details of the outturn position on treasury management transactions in 2010/11;
e) confirms compliance with treasury limits and Prudential Indicators.

In November 2009 CIPFA released the revised Code of Practice for Treasury Management in the Public Services and accompanying Guidance Notes and the revised Prudential Code for Capital Finance in Local Authorities. The CLG also issued revised Guidance on Local Authority Investments for English authorities. The revised Codes/Guidance re-emphasise an appropriate approach to risk management, particularly in relation to the security and liquidity of invested funds. Authorities were also henceforth required to demonstrate value for money when borrowing in advance of need and ensure the security of such funds. Authorities are now also required to have a separate body or committee responsible for the scrutiny of the treasury function.

The Council has revised its treasury policy and practices documentation to take account of the requirements and changes in the revised Codes and Guidance.

1. Treasury Year End Position

The amount of investments outstanding at 31st March 2011 was £66.3m as follows:

	£m
BANKS	
Barclays Bank	15.0
Lloyds TSB	8.0
Santander (UK)	5.0
BUILDING SOCIETIES	
Nationwide	10.0
MONEY MARKET FUNDS	
Standard Life	4.8
Scottish Widows	6.3
Prime Rate	8.0
INSTANT ACCESS ACCOUNTS	
Co-op Reserve	1.8
Santander (UK)	7.4
TOTAL	**66.3**

The amount of investments outstanding at 31st March 2010 was £96.0m as follows:

	Cheshire East	Cheshire County Council	Total
	£m	**£m**	**£m**
BANKS			
Bank of Scotland		7.5	7.5
Barclays Bank	10.9		10.9
Co-operative Bank	4.2	0.7	4.9
Lloyds TSB	15.0		15.0
Royal Bank of Scotland	10.0		10.0
Santander (UK)	16.3	2.7	19.0
Yorkshire Bank (Clydesdale)	10.0		10.0
BUILDING SOCIETIES			
Nationwide Building Society	5.0		5.0
MONEY MARKET FUNDS			
Blackrock		0.2	0.2
Invesco AIM	2.2	5.1	7.3
RBS	1.5	2.0	3.5
Scottish Widows	1.2		1.2
Standard Life	1.5		1.5
TOTAL	**77.8**	**18.2**	**96.0**

The balance of cash held by Cheshire County Council on behalf of Cheshire East was transferred on 23rd July 2010 following the final settlement of the disaggregation of the Cheshire County Council balance sheet. During 2009-10 Cheshire County Council cash was retained on behalf of Cheshire East and Cheshire West & Chester Councils in instant access accounts and money market funds.

Despite interest rates remaining at a record low of 0.5% during 2010/11, the total investment income was £1.16m which exceeded the budgeted target of £1.12m. This was achieved as the overall average rate of interest on all investments in 2010/11 was 1.14% compared to the benchmark 7 day LIBID return of 0.43%. Additional investment income of £109,000 relating to deposits made by the former Cheshire County Council with the Icelandic Heritable Bank was also received in 2010/11.

We will continue to monitor performance during 2011/12 through the benchmarking service provided by the Council's Treasury Management Advisors, Arlingclose. The current position for Cheshire East indicates that performance is average compared to other local authorities taking into account return against credit risk.

At the end of the year 2010/11 the Council had £134m long term loans outstanding. Of this £17m represented loans raised from commercial banks whilst £117m represented loans from the PWLB. In July 2010 the opportunity was taken to restructure £50m of the PWLB debt by replacing a number of maturity loans which had an average rate of 4.22% and 32 years left to run with a new loan repayable in equal instalments over 10 years at a rate of 2.35%. Net savings over the next ten years are forecast at £4.47m of which around £600,000 was achieved in 2010/2011. The final total level of savings will depend on how the maturing amounts of the new loan are refinanced and will depend on the type and maturity period of any replacement loans.

The interest payable in 2010/11 was £5.7m compared to a budget of £7.8m. In addition to the savings achieved through the debt restructuring, no new loans were taken out during the year as the Council was able to internally borrow to fund the capital programme.

2. Icelandic Bank Deposits

On the date Heritable Bank (Heritable) was placed into administration Cheshire County Council had £8.5 million deposited with the bank of which £4.6m is the Cheshire East share. These deposits were immediately frozen. This meant that such monies would not be returned to the Council until such time as the work of the administrator (i.e., to ascertain the assets and liabilities of Heritable and to make dividend payments to the bank's creditors (of which the Council is one) has been completed.

Repayment of monies due from Heritable Bank has been continuing and in April 2010 the administrators announced that we are likely to receive around 85% of the original claim.

From the total claim of £4.62m we have now received £2.32m (just over 50%).

Further repayments are forecast as follows:
2011/2012 - £1.15m (25% of the original claim)
2012/2013 - £0.46m (10% of the original claim)

3. Interest Rates and Prospects for 2010/11

The Councils' treasury advisors, as part of their service assisted in formulating a view on interest rates. However, there has been no change to the bank base rate since March 2010.

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
Base Rate	**0.50%**	**0.50%**	**0.50%**	**0.50%**	**0.50%**

4. Compliance with Treasury Limits

During the financial year the Councils' operated within the treasury limits and Prudential Indicators set out in the Councils' Treasury Policy Statement and annual Treasury Strategy Statement (see section 8).

5. Investment Strategy for 2010/11

The Council had regard to the DCLG Guidance on Local Government Investments ("the Guidance") issued in March 2004 (revised in 2010) and the revised CIPFA Treasury Management Code and the revised Prudential Code ("the CIPFA TM Code").

Investment instruments identified for use in the financial year are listed under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits were set through the Councils' Treasury Management Strategy Statement and Investment Strategy.

Investment Objectives

All investments were in sterling. The general policy objective the Councils' was the prudent investment of its treasury balances. The Councils' investment priorities are the security of capital and liquidity of its investments.

The Councils' aimed to achieve the optimum return on its investments commensurate with the proper levels of security and liquidity. The DCLG maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Security of Capital - The Use of Credit Ratings

There are three principal credit rating agencies and in accordance with the CIPFA Code the Council makes use of all these to establish the credit quality of counterparties and investment schemes. The Council had also determined the minimum long-term, short-term and other credit ratings it deems to be "high" for each category of investment and has regard to institutions which have access to the 2008 Credit Guarantee Scheme.

Monitoring of credit ratings:

- All credit ratings were monitored continuously. The Council is alerted to changes through advice from Treasury Advisors.

- If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Councils' minimum criteria, the further use of that counterparty/investment scheme as a new investment was withdrawn immediately.

- If a counterparty is upgraded, so that it fulfils the Councils' criteria, it was not added immediately to the approved list as the list is approved by named institution.

Use of External Fund Managers

At the start of the year the external cash fund managers Investec managed around £13.4 million on behalf of Cheshire East Borough Council. These funds were recalled as they matured during September, January and March. as these particular investments were no longer generating high returns. The average interest rate gained on the externally managed cash fund during 2010/11 was 1.05%. In May 2011 we have placed £20m with Investec in pooled funds, which are geared to generate higher returns in a low interest rate environment.

6. Borrowing strategy

There have been no new external loans taken out in 2010/2011. This has been due to delays in capital expenditure, the current availability of cash resources and the interest rate environment. This strategy has resulted in a saving of interest charges in 2010/11, but the longer term approach will be to take advantage of short and long term borrowing opportunities with advice from Arlingclose.

7. Economic events of 2010/2011

At the time of determining the strategy for 2010/11, interest rates were expected to remain low in response to the fragile state of the UK economy. Spending cuts and tax increases seemed inevitable post the General Election if the government had a clear majority. The markets had, at the time, viewed a hung parliament as potentially disruptive particularly if combined with a failure to articulate a credible plan to bring down government borrowing. The outlook for growth was uncertain due to consumers and corporates trimming their spending and financial institutions exercising restraint in new lending.

The economy's two headline indicators moved in opposite directions – growth was lacklustre whilst inflation spiked sharply higher. The economy grew by just 1.3% in calendar year 2010; the forecast for 2011 was revised down to 1.7% by the Office of Budget Responsibility in March. Higher commodity, energy and food prices and the increase in VAT to 20% pushed the February 2011 annual inflation figure to 4.4%. The Bank Rate was held at 0.5% as the economy grappled with uneven growth and the austerity measures set out in the coalition government's Comprehensive Spending Review. Significant cuts were made to public expenditure, in particular local government funding.

The US Federal Reserve (the Fed) kept rates on hold at 0.25% following a slowdown in American growth. The European Central Bank maintained rates at 1%, with the markets expecting a rate rise in early Spring.

The credit crisis migrated from banks to European sovereigns. The ratings of Ireland and Portugal were downgraded to the 'triple-B' category whilst the rating of Greece was downgraded to sub-investment (or 'junk') grade. The sovereign rating of Spain was also downgraded but remained in the 'double-A' category. The results from the EU Bank Stress Tests, co-ordinated by the Committee of European Banking Supervisors, highlighted that only 7 out of the 91 institutions failed the 'adverse scenario' tests. The tests were a helpful step forward, but there were doubts if they were far-reaching or demanding enough. The main UK banks' (Barclays, HSBC, Lloyds and RBS) Tier 1 ratios all remained above 9% under both the 'benchmark scenario' and the 'adverse scenario' stress tests. The tests will be repeated in the Spring of 2011.

Gilts benefitted from the decisive Comprehensive Spending Review (CSR) plans as well as from their relative 'safe haven' status in the face of European sovereign weakness. 5-year and 10-year gilt yields fells to lows of 1.44% and 2.83% respectively. However yields rose in the final quarter across all gilt maturities on concern that higher inflation would become embedded and greatly diminish the real rate of return for fixed income investors.

During the year money market rates increased marginally at the shorter end (overnight to 3 months). 6 - 12 month rates increased between 0.25% to 0.30% over the 12 month period reflecting the expectation that the Bank Rate would be raised later in 2011

8. Prudential Indicators 2010/11

<u>Authorised Limit for External Debt</u>

The estimates and actuals for the authorised limits for 2010/11 are

	PI Limit	Actual
	£000	*£000*
Borrowing	218,000	142,143
Other long term liabilities	0	0

Operational Boundary for External Debt
The estimates and actuals for the operational boundary (lower than authorised limit due to cash flow variations) for 2010/11 are

	PI Limit	Actual
	£000	*£000*
Borrowing	210,000	134,403
Other long term liabilities	0	0

Upper Limits for Fixed and Variable Rate Interest Exposure

	PI Limit	Actual (peak)
	%	%
Upper limit for Fixed Interest Rate Exposure:	100	
Debt		100
Investments		89
Upper Limit for Variable Interest Rate Exposure	100	
Debt		0
Investments		61

Maturity Structure of Fixed Rate Debt

	PI Limit	Actual
	%	%
Upper limit on borrowing maturing in:		
Under 12 months	25	9
Over 12 months but less than 24 months	25	4
Over 24 months but less than 5 years	35	17
Over 5 years but less than 10 years	50	17
Over 10 years but less than 20 years	100	9
Over 20 years but less than 30 years	100	31
Over 30 years but less than 40 years	100	29
Over 40 years but less than 50 years	100	28
Over 50 years	100	0