

Cheltenham Borough Council
Treasury Management Panel – 6th June 2011

Treasury Outturn 2010/11

Report of the Director, Resources

1. Introduction

- 1.1** Treasury Management in Local Government is governed by the CIPFA Code of Practice on Treasury Management in the Public Services and this Council has adopted the Code and complies with its requirements, one of which is the receipt by Treasury Council of an Annual Review Report after the financial year end.

2. Economic Outlook for 2010/11

- 2.1** At the time of determining the Treasury 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, but were forecast to rise through the second part of the financial year. Spending cuts and tax increases seemed inevitable post the General Election if the government had a clear majority. The money markets at the time viewed a hung parliament as potentially disruptive particularly if combined with a failure to voice a credible plan to bring down government borrowing. The outlook for growth was uncertain due to consumers and businesses trimming their spending and financial institutions exercising restraint in new lending.
- 2.2** The economy's two headline indicators moved in opposite directions - growth was uninspiring whilst inflation spiked sharply higher. The economy grew by just 1.3% in 2010 and the forecast rate for 2011 was revised down to 1.7% by the Office of Budget Responsibility in March 2011 from 2%. Consumer Price Inflation during the year hit a high of 4.4% in February 2011 but then unexpectedly dropped back to 4% in March 2011, led by falling food and non-alcoholic beverages. The decrease eased pressure on the Bank of England to raise the Bank Rate from 0.50%, which had remained at that rate throughout 2010/11.
- 2.3** Consumer confidence and spending continues to be affected by modest wage increases, weak house price growth and a shortage of cheap credit. Unemployment is just over 2.5 million and will increase as the public sector shrinks but private sector employment grows at only a modest pace.
- 2.4** The credit crisis migrated from banks to European sovereigns in 2010/11. The ratings of Ireland, Spain, Portugal, and Greece were all downgraded. The results from the EU Bank Stress Tests, co-ordinated by the Committee of European banking Supervisors, highlighted that only 7 out of 91 institutions failed the 'adverse scenario' tests. The tests were a helpful step forward, but doubts remained if they went far enough. The main UK banks (Barclays, HSBC, Lloyds Banking Group and RBS) all passed the test.

3. Portfolio position 1/4/10-31/3/11

Movements in the Council's borrowing during 2010/11 can be seen in the table below. Long term loans are deemed to be those repayable over a period of more than one year.

| Source of Loan | Balance at 1 April 2010 £ | Raised during the year £ | Repaid during the year £ | Balance at 31 March 2011 £ |
|-----------------------------------|------------------------------|-----------------------------|-----------------------------|-------------------------------|
| Temporary Borrowing | | | | |
| - Building Societies | 1,200,000 | 5,000,000 | 1,200,000 | 5,000,000 |
| - Banks | 0 | 0 | 0 | 0 |
| - Local Authorities | 15,800,000 | 102,840,000 | 110,640,000 | 8,000,000 |
| Temporary Investment | 614,303 | 2,705,513 | 2,980,026 | 339,790 |
| Total Short Term Borrowing | 17,614,303 | 110,545,513 | 114,820,026 | 13,339,790 |
| Long Term Borrowing | | | | |
| - Public Works Loan Board | 11,000,000 | 0 | 0 | 11,000,000 |
| - Market Loans | 15,900,000 | 0 | 0 | 15,900,000 |
| Long Term Borrowing | 26,900,000 | 0 | 0 | 26,900,000 |
| Total External Borrowing | 44,514,303 | 110,545,513 | 114,820,026 | 40,239,790 |

3.1 In 2010/11 the Council's actual debt management costs (borrowing) were £1,209,976 compared to a revised budget of £1,212,600, a saving of £2,624. The weighted average rate on all loans for 2010/11 was 3.13% (2009/10 2.81%) against a revised estimated rate of 3.08%.

The interest repaid from the HRA for the use of debt balances amounted to £524,956 against a revised budget of £576,900. The primary reason for this shortfall is that the calculation for the HRA Item 8 Debit at revised budget estimated the consolidated rate of interest to be 3.08% on all borrowing, however due to the Council's weighted average of total borrowing for 2010/11 being lower than the Capital Financing Requirement (CFR), a different formula was used to calculate the HRA Item 8 Debit. This resulted in the HRA being charged 2.80% compared with 3.13% and a shortfall of £51,944 interest payable to the General Fund occurred. Furthermore due to slippage in capital expenditure and savings made on revenue expenditure the HRA revenue balances were higher than estimated at revised budget time. Interest paid to the HRA for revenue balances amounted to £83,220 compared with the revised budget of £74,200.

3.2 No debt rescheduling was undertaken in 2010/11. One of the reasons for this was due to a change in the rates of PWLB loans. Following the Comprehensive Spending Review in October 2010, on instruction from HM Treasury, the PWLB increased the margin for new borrowing to average 1% above the yield in the corresponding UK Government Gilt. Premature repayment rates did not benefit from this increase, which potentially makes future rescheduling of PWLB loans more challenging.

4. Investments

4.1 The CLG's Guidance on Local Government Investments in England was revised during 2009/10 and came into effect on 1st April 2010, reiterating security and liquidity as the primary objectives of a prudent investment policy. In the revised Guidance, Specified Investments are those made with a body or scheme of "high credit quality". Both the Guidance and the revised Treasury Management Code emphasise that counterparty credit criteria should not rely on credit ratings alone but should include a wider range of indicators. The revised Code nonetheless requires that ratings assigned by all three agencies – Fitch, Moody's and Standard & Poor's be taken into account and the lowest rating be used.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2010/11. Investments made during the year were kept to Call Accounts and deposits with UK banks which met the credit criteria and are all systemically important to the UK's banking system.

4.2 Investments - Movements in the Council's investment portfolio during 2010/11 can be seen in the table below.

| Source of Loan | Balance at 1 April 2010 | Raised during the year | Repaid during the year | Balance at 31 March 2011 |
|---------------------------------|--------------------------------|-------------------------------|-------------------------------|---------------------------------|
| Temporary Lending | £ | £ | £ | £ |
| - Building Societies | 0 | 0 | 0 | 0 |
| - Banks | 2,000,000 | 7,800,000 | 4,800,000 | 5,000,000 |
| Bank of Scotland Call A/C | 0 | 60,460,000 | 59,560,000 | 900,000 |
| | 0 | | | |
| Total Short Term Lending | 2,000,000 | 68,260,000 | 64,360,000 | 5,900,000 |

| Long Term Lending | Balance at 1 April 2010 £ | Raised during the year £ | Repaid during the year £ | Balance at 31 March 2011 £ |
|-----------------------------------|--------------------------------------|-------------------------------------|-------------------------------------|---------------------------------------|
| - Building Societies | 0 | 0 | 0 | 0 |
| - Banks | 13,950,000 | 0 | 2,540,000 | 11,410,000 |
| Total Long Term Lending | 13,950,000 | 0 | 2,540,000 | 11,410,000 |
| Total External Investments | 15,950,000 | 68,260,000 | 66,900,000 | 17,310,000 |

- 4.3** The Council had £9.56 million deposited in the collapsed Icelandic banks as at 31st March 2011. The Council has received £540,000 from the administrators of Kaupthing Singer & Friedlander (KSF) in 2010/11, which equates to 18p in the pound and a total of 53p in the pound overall. Of the original £3m deposited with KSF, £1.41m principle is still due. Recent information provided by the administrators have indicated a recovery rate of 78p to 86p in the £ (up from 65p to 78p reported in the 2009/10 outturn report).
- 4.4** The deposits with Glitnir Bank (£3m) and Landbanki Bank (£5m) have been through the process of legal proceedings. Both cases were heard by the Icelandic District Court in early 2011, which decided that UK Local Authorities' deposits should be classified as priority claims. The decision of the Icelandic District Court is being appealed to the Icelandic Supreme Court by the other parties and a final judgement is anticipated in the autumn of 2011. If the Supreme Court confirms the deposit claims of UK Local Authorities are priority claims, the Council could receive all outstanding monies with Glitnir towards the end of 2011. If the Supreme Court decides the claims are not priority claims, the recovery will be the same as that of other general unsecured creditors, which is expected to be 29% and will be paid over a longer period. Similarly with Landsbanki, if depositor priority is upheld creditors will recover 95% over a number of years. If depositor priority is not upheld, then the recovery for all general unsecured creditors is expected to be 38%.
- 4.6** The Council's investment income for 2010/11 was £228,577 compared to a revised estimate of £221,100, a surplus of £7,477. As mentioned in paragraph 3.1 the HRA revenue balances are higher than forecast as less capital expenditure was required which resulted in the General Fund having more to invest for a longer period.
- 4.7** At the year end, the overall treasury management position (external borrowing less external investments) was such that the Council was a net borrower to the sum of £22.9m (2009/10 £28.4m). The overall interest receivable and payable for 2010/11 was an underspend against revised budget of £10,101 on the General Fund while the Housing Revenue Account (HRA) is £60,964 favourable against revised budget, meaning a shortfall in interest of £50,863 to report for the financial year.

5. Credit Risk

As stated in the Annual Investment Strategy 2010/10 the Council will monitor and update the credit standing of the institutions on a regular basis. Information was not just based on credit ratings but was also assessed and monitored with reference to:-

- Statement of Government Support
- Credit default Swaps
- Corporate developments
- Share price

Counterparty credit quality has been maintained as demonstrated by the Credit Score Analysis table summarised below on all deposits for the Council held during the 2010/11 financial year which has been provided by Arlingclose Ltd.

| Date | Total Investments (Excluding Icelandic Banks) | Average rate of Investments | Time Weighted Average Credit Rating | Time Weighted Average Credit Risk Score | Value Weighted Average Credit Risk Score | Average Life (days) |
|------------|--|-----------------------------|-------------------------------------|---|--|---------------------|
| 31/03/2010 | £6m | 4.57% | A+ | 5.10 | 4.89 | 452 |
| 30/06/2010 | £7.4m | 3.85% | A | 5.56 | 4.78 | 194 |
| 30/09/2010 | £6.5m | 2.84% | A+ | 5.12 | 4.74 | 249 |
| 31/12/2010 | £9.9m | 2.17% | A+ | 5.05 | 4.67 | 144 |
| 31/03/2011 | £7.9m | 2.67% | A+ | 4.77 | 4.67 | 195 |

Appendix 9a gives a brief description of the credit scores and headings included in the table above.

7. Treasury Limits and Prudential indicators

7.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Annual Treasury Strategy Statement. In 2010/11 the Council set an authorised limit of £76m and an operational limit for borrowing of £69m, which was not breached during the financial year.

8. Treasury Management Advisors

8.1 Arlingclose Ltd were first appointed as the Council's treasury management advisors in April 2007 and the contract was extended for a further year from 1st April 2011.

During 2010/11 Arlingclose as part of their service have delivered:-

- Over 55 Counterparty Credit updates
- 26 Technical updates
- 28 Economic updates/Interest rate forecasts
- Held 9 workshops to attend to learn new legislation/changes in treasury management
- Quarterly reviews on the Councils Debt and Investment portfolio
- Attended 2 Treasury Management Panel meetings in 2010/11
- Provide templates for treasury reports – x 3
- Email 2 weekly bulletins – Preview and a review of the week.

8.2 The Council is clear as to the services it expects and is provided under the contract. The Council is also clear that overall responsibility for treasury management remains with the Council.

9. Conclusions

9.1 Members are asked to note the outturn for 2010/11.