Cheltenham Borough Council

Treasury Management Panel – 13th June 2012

Treasury Outturn 2011/12

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 Cabinet/Council of an Annual Review Report after the financial year end.

2. Economic Outlook for 2011/12

2.1 At the time of determining the Treasury Strategy Statement for 2011/12 in February 2011, there were tentative signs that the UK was emerging from recession with the worst of the financial crisis behind it. Recovery in growth was expected to be slow and uneven as the austerity measures announced in the 2010 Comprehensive Spending Review were implemented in order to bring down the budget deficit and government borrowing and rebalance the economy and public sector finances. Inflation measured by the Consumer Price Index (CPI) had remained stubbornly above 3% and unemployment was at a 16-year high at 2.5 million and was expected to rise as the public and private sector contracted. There was also a high degree of uncertainty surrounding Eurozone sovereign debt sustainability.

2.2 Inflation during 2011/12 remained high with CPI and the Retail Price Index (RPI) rising in September 2011 to 5.2% and 5.6% respectively primarily due to escalating utility prices and the January 2011 increase in VAT to 20%. Inflation eased slowly as reductions in transport costs, food prices, intensifying competition amongst retailers and supermarkets and the VAT effect falling out in 2012, pushed February 2012 CPI down to 3.4% and RPI to 3.7%. This, however, was not enough to offset low wage growth and, as result, Britons suffered the biggest drop in disposable income in more than three decades.

2.3 Growth, on the other hand remained indefinable. The Bank's Quarterly Inflation Reports painted a bleak picture as the outlook was downgraded to around 1% in 2011 and 2012. The unresolved problems in the Eurozone weighed negatively on global economic prospects. UK Gross Domestic Product was positive in only the first and third calendar quarters of 2011 and registered just 0.5% for the whole of 2011. Unemployment rose to 2.68million and worryingly youth unemployment broke through the 1 million barrier. House prices struggled to show sustained growth and consumer confidence remained fragile.

2.4 It was not surprising that the Bank of England Monetary Policy Committee maintained the status quo on the Bank Rate which has now been held at 0.5% since March 2009, but increased asset purchases by £75bn in October 2011 and another £50bn in February 2012 taking the Quantitative Easing (QE) total to £325bn. The government struck broadly to its austerity plans as the economy was rebalancing slowly. The opinion of the independent Office for Budget Responsibility (OBR) was that the government was on track to meet its fiscal targets but identified oil price shocks and a further deterioration in Europe as the main risks to the outlook for growth and in meeting the fiscal target.

2.5 The US economy continued to show tentative, positive signs of growth alongside a gradual decline in the unemployment rate. The US Federal Reserve (the Fed) committed to keeping policy rates low until 2014, although a modest shift in the Fed's language in March, alongside an improvement in economic activity, cast doubts about the stability of the Fed's policy commitment.

2.6 In Europe, sovereign debt problems for some minor countries became critical. Several policy initiatives were largely unsuccessful. Two bailout packages were required for Greece and one for Portugal, and the contagion spread to Spain and Italy whose sovereign bonds came under increased stress in November 2011. Rating agencies downgraded nine European sovereigns.

3. Portfolio position 1/4/11-31/3/12

Movements in the Council's borrowing during 2011/12 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 **Temporary Borrowing**	**Balance at 1 April 2011** **£**	**Raised during the year** **£**	**Repaid during the year** **£**	**Balance at 31 March 2012** **£**
- Building Societies	5,000,000	0	5,000,000	0
- Banks	0	0	0	0
- Local Authorities	8,000,000	104,840,000	107,740,000	5,100,000
Temporary Investment	323,759	1,022,896	1,343,655	3,000
Total Short Term Borrowing	**13,323,759**	**105,862,896**	**114,083,655**	**5,103,000**
Long Term Borrowing				
- Public Works Loan Board	11,000,0000	29,814,000	7,669	40,806,331
- Market Loans	15,900,0000	0	0	15,900,000
Long Term Borrowing	**26,900,000**	**29,814,000**	**7,669**	**56,706,331**
Total External Borrowing	**40,223,759**	**135,676,896**	**114,091,324**	**61,809,331**

3.1 In 2011/12 the Council's actual debt management costs (borrowing) were £1,223,606 compared to a revised budget of £1,216,700, a deficit of £6,906. Exchange rate losses on Icelandic distributions received in 2011/2012 amounted to £9,303.The weighted average rate on all loans for 2011/12 was 3.25% (2010/11 3.13%) against a revised estimated rate of 3.03%. Given the significant cuts to local government funding putting pressure on the Council's finances, the strategy followed was to minimise debt interest payments by reducing temporary debt to cover cash-flow shortfalls by using maturing investments.

3.2 The Localism Act passed into law in November 2011 which enabled the reform of council housing finance. The Housing Revenue Account (HRA) subsidy system has now been abolished and replaced with self-financing whereby authorities support their own housing stock from their own income. This reform required a re-adjustment of each authority's housing–related debt based on a valuation of its council housing stock. The CLG issued the final Settlement Payment Determination in February 2012. The settlement date for the self financing transaction was 28th March 2012. As the Council's debt level generated by the housing reform model was higher than the Subsidy Capital Financing Requirement (SCFR), the Council was required to pay the CLG the difference between the two, which was £27.414m. This required the Council to fund the full settlement by taking on borrowing. A preferential set of PWLB rates were available for this transaction on 26th March 2012 only, for settlement on 28th March 2012. Given the one-off nature of the PWLB funding window and the advantages offered in terms of rate, loan structure and administration, the Council took the decision to fund £27.414m through new borrowing from the PWLB. Three separate loans were taken for periods of between 20 and 30 years at an weighted average of 3.42%.

3.3 The treasury management implications of HRA reform and an appropriate strategy to manage the transaction were discussed with the Council's Treasury Advisors and Housing Consultants. The Council will henceforth adopt a two pool approach in relation to the allocation of debt between the General Fund and HRA.

3.4 The interest repaid from the HRA for the use of debt balances amounted to £548,256 against a revised budget of £528,700. The reason for this increase was down to the additional interest due on the £27.414m new PWLB borrowing taken out in late March and also the General Fund (GF) receiving more in interest from the HRA for its share of the debt held by the Council. The weighted average rate of interest on all borrowing for 2011/12 was estimated to be 3.03% but came in at 3.25%.

3.5 The Council took out further PWLB borrowing during the financial year on behalf of Cheltenham Borough Homes (£1.4m) and The Gloucestershire Everyman Theatre (£1m). These loans were taken on an annuity basis in which the named organisations are repaying back in full to the Council based on the loan terms taken with the PWLB, ensuring the GF is cost neutral.

4. Investments

4.1 The CLG's Guidance on Local Government Investments in England requires local authorities to focus on security and liquidity, rather than yield.

4.2 Investments - Movements in the Council's investment portfolio during 2011/12 can be seen in the table below.

Source of Loan **Temporary Lending**	**Balance at 1 April 2011 £**	**Raised during the year £**	**Repaid during the year £**	**Balance at 31 March 2012 £**
Building Societies	0	0	0	0
Banks	5,000,000	2,000,000	5,000,000	2,000,000
Bank of Scotland Call A/C	900,000	43,250,000	44,150,000	0
Santander Call A/C	0	25,650,000	23,050,000	2,600,000
CBH	0	1,400,000	1,400,000	0
Glos Airport	0	1,190,585	0	1,190,585
Glos Everyman Theatre	0	1,000,000	1,000,000	0
Total Short Term Lending	**5,900,000**	**74,490,585**	**74,600,000**	**5,790,585**
Long Term Lending	**Balance at 1 April 2011 £**	**Raised during the year £**	**Repaid during the year £**	**Balance at 31 March 2012 £**
- Banks	0	0	0	0
- Icelandic Banks	9,410,000	0	4,235,756	5,174,244
Total Long Term Lending	**9,410,000**	**0**	**4,235,756**	**5,174,244**
Total External Investments	**15,310,000**	**74,490,585**	**78,835,756**	**10,964,829**

4.3 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 2011/12.

4.4 In December 2011, the Icelandic Supreme Court ruled that local authority deposits with Glitnir and Landsbanki qualified for priority status and since the ruling several payments have been made by the banks winding-up-boards.

4.5 The table below shows the detailed repayments in respect of the specific Icelandic investments held in administration:

Icelandic Deposits Held	Original Deposits	Amount Received to date	Amount Outstanding
	£	**£**	**£**
Kaupthing Singer & Friedlander	2,000,000	1,260,000	740,000
Kaupthing Singer & Friedlander	1,000,000	630,000	370,000
Glitnir	3,000,000	2,427,600	572,400
Landsbanki	2,000,000	599,380	1,400,620
Landsbanki	2,000,000	599,467	1,400,533
Landsbanki	1,000,000	309,309	690,691
TOTAL	**11,000,000**	**5,825,756**	**5,174,244**

4.6 Kaupthing Singer & Friedlander is estimated to repay between 81p to 86p in the pound. To date (31st March 2012) 63p in the pound has been recovered. In May 2012 a further 10p in the pound was distributed to authorities bringing the recovery rate to 73%.

4.7 Glitnir Winding-up-Board repaid in March 2012 approximately 81p in the pound from a mixture of Sterling, Euro and US Dollars. The remaining 19% remains held in Icelandic Krona in an escrow account.

4.8 Landsbanki Winding-up-Board repaid approximately 30p in the pound in February 2012, with a further 2p in the pound held in Icelandic Krona in an escrow account. It had been expected that 98p in the pound would be recovered although this has recently been upgraded to full recovery (ie.100%). A second distribution was recently made in May 2012 which was received in Sterling. This amounted to 12p in the pound bringing the total to 42p in the pound returned to date. Future distribution payments are likely to occur over the coming years.

4.9 Issues remain around foreign exchange risks, as payments have been and will continue to be received in Euros, US Dollars, GBP and Icelandic Krona. The Council has discussed these foreign exchange transactions with its bank and suitable arrangements have been put in place to accept the payments. There are still uncertainties regarding funds currently held in Icelandic Krona, as they cannot currently be converted into GBP. The LGA in conjunction with those authorities affected, are working on a practical solution for all parties concerned.

4.10 The Council's investment income for 2011/12 was £189,860 compared to a revised estimate of £172,500, a surplus of £17,360. Cash resources improved in 2011/12 due to the return of some Icelandic deposits, which insured a higher return of interest from the Business Call Accounts, due to extending the length of time the deposits could remain in them.

4.11 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 £51.6m (2010/11 £22.9m). The overall interest receivable and payable for 2011/12 was a surplus of £10,454 against revised budget on the General Fund while the Housing Revenue Account (HRA) is £22,164 over against revised budget, resulting in surplus interest of £32,618 to report for the financial year.

5. Credit Risk

As stated in the Annual Investment Strategy 2011/12 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

The minimum long-term counterparty credit rating determined for the 2011/12 treasury strategy was A+/A1 across rating agencies Fitch, S&P and Moody's. This particular criterion was amended and approved at Council on the 10th February 2012 to A-/A3 in response to downgrades in credit ratings below A+ of many institutions considered to be systemically important to the financial system. The downgrades were driven principally by the agencies' view the extent of future government support rather than deterioration in the institutions' credit worthiness.

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 2011/12 financial year which has been provided by Arlingclose Ltd.

Date	Value Weighted Average Credit Risk Score	Value Weighted Average Credit Rating	Time Weighted Average Credit Risk Score	Time Weighted Average Credit Rating	Average Life (days)
31/03/2011	4.67	A+	5.05	A+	144
30/06/2011	4.67	A+	4.77	A+	195
30/09/2011	4.71	A+	4.38	AA-	141
31/12/2011	3.98	AA-	4.92	A+	51
31/03/2012	5.00	A+	5.00	A+	49

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investments according to the maturity of the deposit. The Council aimed to achieve a score of 5 or lower, to reflect the Council's overriding priority of security of monies invested and the minimum credit rating of threshold A+ for investment counterparties.

6. Treasury Limits and Prudential indicators

6.1 The Council can confirm that it has complied with its Prudential Indicators for 2011/12, which was set in February 2011 as part of the Council's Treasury Management Strategy. The Authorised and Borrowing Limits were amended and approved by Council on the 10th February to enable further borrowing in relation to the HRA self-financing requirements. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2011/12. None of the Prudential Indicators has been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

7. Treasury Management Advisors

7.1 Arlingclose Ltd were appointed as the Council's treasury management advisors in April 2007 and the contract was extended for a further 7 months from 1st April 2012.

During 2011/12 Arlingclose as part of their service have delivered:-

- Over 100 Counterparty Credit updates (55 – 10/11)
- 23 Technical updates (26 -10/11)
- 63 Economic updates/Interest rate forecasts (28 – (10/11)
- Held 10 workshops to attend to learn new legislation/changes in treasury management (9 – 10/11)

- Quarterly reviews on the Councils Debt and Investment portfolio

- Attended 3 Treasury Management Panel meetings in 2011/12 (2 -10/11)

- Email 2 weekly bulletins – Preview and a review of the week.

7.2 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.

8. Conclusions

8.1 Members are asked to note the outturn for 2011/12.