Appendices
8

Item No.
9

NORTHAMPTON
BOROUGH COUNCIL

CABINET REPORT

Report Title	TREASURY MANAGEMENT OUTTURN 2010-11

AGENDA STATUS: **PUBLIC**

Cabinet Meeting Date:	27 July 2011
Key Decision:	NO
Listed on Forward Plan:	YES
Within Policy:	YES
Policy Document:	NO
Directorate:	Finance and Support
Accountable Cabinet Member:	Alan Bottwood
Ward(s)	Not Applicable

1. Purpose

1.1 To inform the Cabinet of the Council's performance in relation to its borrowing and investment strategy for 2010-11.

2. Recommendations

2.1 That Cabinet recommend to Council that they note the Council's treasury management performance in 2010-11.

3. Issues and Choices

3.1 Report Background

3.1.1 The Council adopted the latest version of the CIPFA Code of Practice on Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes ("the Treasury Management Code of Practice") following its publication in 2009.

3.1.2 The Treasury Management Code of Practice includes recommendations on reporting requirements. The table below shows how the specific requirements have been incorporated into this report.

Reporting Requirement	Reference
Report on the risk implications of decisions taken and transactions executed	Paragraph 3.2.6
Transactions executed and their revenue (current) effects	Paragraph 3.2.7 to 3.2.10 Annexes B to F
Performance report	Paragraph 3.2.7 to 3.2.10 Annexes B to F
Monitoring of treasury management indicators for local authorities.	Paragraph 3.2.11 to 3.2.12 Annex G
Compliance report on agreed policies/practices and on statutory/regulatory requirements	Paragraph 3.2.13

3.2 Issues

Accounting & Audit Issues

3.2.1 The 2010 CIPFA Code of Practice on Local Authority Accounting includes a complex set of regulations on accounting for financial instruments. These requirements have been fully complied with in the preparation of the Council's Statement of Accounts.

3.2.2 The regulations include the values at which financial instruments, including borrowing and investments, should be calculated for inclusion on the balance sheet at year-end. In some instances, this is at amortised cost, whereby the balance sheet value is written up or down via the comprehensive income and expenditure account over the life of the instrument to reflect costs or benefits, such as transaction costs or interest earned or due to date. Alternatively, financial instruments may be valued at their original cash value

3.2.3 In summary, and broadly speaking, the balance sheet values of the Council's debt and investments at 31 March 2011 are shown in the following ways:

Borrowing (Financial Liabilities)	
Long term borrowing	Amortised cost
Short term borrowing	Original (cash) value
Investments (Financial Assets)	
Deposit and call accounts (cash equivalents)	Original (cash) value
Money market funds (cash equivalents)	Original (cash) value
Short term money market investments up to three months duration (cash equivalents)	Original (cash) value
Short term money market investments over three months duration	Amortised cost

3.2.4 Outturn figures relating to borrowing and investments are shown and discussed at paragraphs 3.2.7 to 3.2.9 below, and at Annexes B, C and D. All outturn figures contained in this report are subject to external scrutiny, through the annual audit by the Audit Commission of the Council's Statement of Accounts

Economic Environment and Interest Rates

3.2.5 2010-11 has brought further significant changes in the economic environment and the trend of low interest rates has continued throughout, against a background of a Bank of England base rate that has remained consistently at 0.5% throughout the year. Commentary on the economic environment and interest rates provided by Sector, the Council's treasury management advisers, is included at **Annex A1**. Definitions of the key terms used (Bank of England base rate, LIBID rate, LIBOR rate) and an analysis of interest rate movements in the year are included at **Annex A2.**

Risk implications of decisions taken and transactions executed

3.2.6 The Treasury Management Code of Practice identifies eight main treasury management risks. Definitions of these are included in the Council's Treasury Management Practices (TMPs) for 2010-11 reported to Cabinet on 24

February 2010 & Council 25 February 2010. The management of these risks during 2010-11 is covered in the following paragraphs.

a) Credit and counterparty risk – In the economic and banking environment that prevailed during 2010-11, this was an area of considerable risk for all local authority investors. The Council managed this risk extremely closely during the year through strict adherence to its treasury management policies and practices and a tightly controlled counterparty list that took into account a range of relevant factors including sovereign rating, credit ratings, inclusion in the UK banking system support package and credit default swap spreads. The advice of the Council's treasury management advisors was also an underlying feature. The Council was not subject to the failure of any of its counterparties to meet their contractual obligations to the Council under treasury transactions during 2010-11.

b) Liquidity risk – This was managed effectively during 2010-11 through pro-active management of the Council's cashflow, including the choice of suitable investment values and maturity dates and the maintenance of sufficient levels of liquid cash in bank and deposit accounts. The Council also maintained its access to overdraft facilities and temporary borrowing facilities as a contingency for use in exceptional circumstances. The Council undertook no long- or short-term borrowing during 2010-11.

c) Interest rate risk - The Council's upper limits for fixed and variable interest rate exposures in respect of net external debt are managed as treasury indicators. These are reported at **Annex G**. A technical breach of the treasury indicator for fixed rate interest rate exposure was reported to Council on 15 September 2011. This was due to the existing long term investments over 365 days falling out of the investment portfolio and being replaced with shorter term investments due to the prevailing economic conditions and interest rate environment. At the same meeting the Council approved a change to the original indicator from zero to £10m for the remainder of 2010-11.

d) Exchange rate risk - The Council has a policy of only entering into loans and investments that are settled in £ sterling, and has no treasury management exposure to this category of risk.

e) Refinancing risk – The Council did not refinance any of its debt during 2010-11 and was therefore not exposed to this category of risk during the year.

f) Legal and regulatory risk - The Council has carried out its treasury management activities for 2010-11 within the current legal and regulatory framework. Officers responsible for strategic and operational treasury management decisions are required to keep abreast of new legislation and regulations impacting on the treasury management function, and have applied any changes as necessary. Legal and regulatory risks associated with other organisations with which the Council deals in its treasury management activities have been managed through counterparty risk management policies.

g) Fraud, error and corruption and contingency management - Officers involved in treasury management are explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council. All treasury activities must be carried out in strict accordance with the agreed systems and procedures in order to prevent opportunities for fraud, error and corruption. The measures in place to ensure this include a scheme of delegation and segregation of duties, internal audit of the treasury function, detailed procedure notes for dealing and other treasury functions, and emergency and contingency planning arrangements (including a business continuity plan for treasury management). The most recent internal audit report on treasury management (2009-10) gave a high level of assurance with no recommendations for action.

h) Market risk – The Council did not hold any investments during 2010-11 that were subject to fluctuations in market value, such as gilts, CDs (Certificates of Deposit) and bonds, and was therefore not exposed to this category of risk during the year. However, the Council does have deposits placed in a Money Market Fund, whereby the underlying assets of the fund are subject to capital fluctuations. The movements in capital are as a result of interest rate risk and credit risk. The structure of the fund minimises the movement of capital value due to the restrictions laid down by the credit rating agencies.

Performance Report - Borrowing

3.2.7 Long Term Borrowing

a) **Annex B** shows the Council's long-term debt as at 31 March 2011 at amortised cost. The total debt outstanding is £32m. Of this amount, 77% (£24.8m) is in the form of money market LOBO loans, 19% (£6m) is PWLB borrowing and the remaining balance of 4% (£1.2m) is in the form of an annuity loan with the Homes and Communities Agency (HCA).

b) No loans were repaid during the year other than the scheduled repayment of the principal element of the annuity with HCA (£16k) due in 2010-11. The principal amount due to HCA in 2011-12 (£17k) is treated as short-term borrowing and is included in the discussion at paragraph 3.2.8 below.

c) No new borrowing or rescheduling of loans took place during the financial year.

d) Under Section 3 of the Local Government Act 2003, the Council is required to set an annual affordable borrowing limit. This limit is also set as a prudential indicator, i.e. the authorised limit for external debt. The affordable borrowing limit for 2010-11 was set by Council at its meeting on 25 February 2010.

Compliance is demonstrated below:

	Affordable Borrowing Limit as set 25 February 2010	**Maximum Actual Amount Outstanding in Year**
Overall Borrowing	£50m	£32m

e) **Annex C** illustrates the Council's long-term debt maturity profile as at 31 March 2011.

Two LOBO loans totalling £15.6m are due for repayment in 2014-15. Rescheduling of these loans is not available unless the lender opts to increase rates at the six monthly call date, which is not anticipated in the current interest rate environment. Options for the repayment and, if applicable, refinancing of these loans will be fully considered and evaluated as their maturity date approaches, and advice taken from Sector, the Council's treasury management advisor.

3.2.8 Short Term Borrowing

a) The year-end position on temporary borrowing, and the range of rates applied, is set out at **Annex D**.

b) The Council has long-standing agreements with two local organisations, Billing Parish Council and Northampton Volunteering Centre, for the short-term deposit of funds with the Council. Accounting regulations require that these be treated in the accounts as short-term borrowing. The interest rate applicable on these accounts is set quarterly using the Council's average investment rate for the previous quarter, less 0.5% to cover administrative costs.

c) The repayment of the principal element of the HCA annuity (£17k) due in 2011-12 is also treated as short term borrowing in the accounts in order to comply with accounting requirements.

Performance Report - Investments

3.2.9 Investments Strategy

a) The CLG Guidance on Local Government Investments requires Councils to set an Investment Strategy. The regulations in force for 2010-11 required this to cover types of investment, liquidity issues, interest rates and prudential indicators. The Council's Investment Strategy for 2010-11 was included in the Treasury Strategy for 2010-11, approved by Council at its meeting on 25 February 2010.

b) Investments are split into 2 categories:

   (i) Specified investments which are broadly sterling investments, not exceeding 364 days and with a high credit rating; and

   (ii) Non-specified investments that do not satisfy the conditions for specified investments.

c) The Council's Investment Strategy for 2010-11 set out the Council's credit rating criteria for specified investments, and the types of unspecified investments that it might enter into, including investments over 364 days.

d) Investments and deposits are made only with financial institutions that meet identified minimum credit criteria that includes, but is not entirely dependent on, external credit ratings, including sovereign ratings. Investments periods are determined in line with the maximum periods recommended by Sector, the Council's treasury management advisor. In addition, the Investment Strategy imposes Council specific value and investment period limits for each category of approved counterparty.

e) In August 2010, the Chief Finance Officer approved a change to the Investment Strategy, extending the range of counterparties available for investments over 364 days. This was in order to reduce the risk that the Council could be unable to take advantage of preferential interest rates for long-term investments if they arose. This change was reported in the treasury management mid-year report to Cabinet on 15 December 2010 and Council on 17 January 2011.

f) The maximum limits for placements with individual or group counterparties are £15m and 729 days for UK nationalised or part nationalised banking institutions and UK banks or building societies supported by the UK banking system support package, and £12m and 729 days for counterparties having sovereign ratings of AAA (Overseas or UK). Lower limits apply in many instances depending on credit ratings and other factors specific to each institution.

g) Instant access deposit accounts and call accounts continued to be used during 2010-11 to ensure liquidity and security of funds. The rates on offer on these accounts have also been attractive compared with short-term money market rates for investments up to 6 months. The average balance in deposit and call accounts throughout the year was £15m, representing 19% of the overall investment portfolio.

h) In July 2010, the Chief Finance Officer gave approval for the use of triple-A rated money market funds. These have the benefits of high credit rating, high liquidity, easy access to funds, portfolio diversification, competitive returns, and administrative convenience. In October 2010, the Council opened a triple-A rated money market fund with Ignis, making an initial deposit of £5m in December 2010.

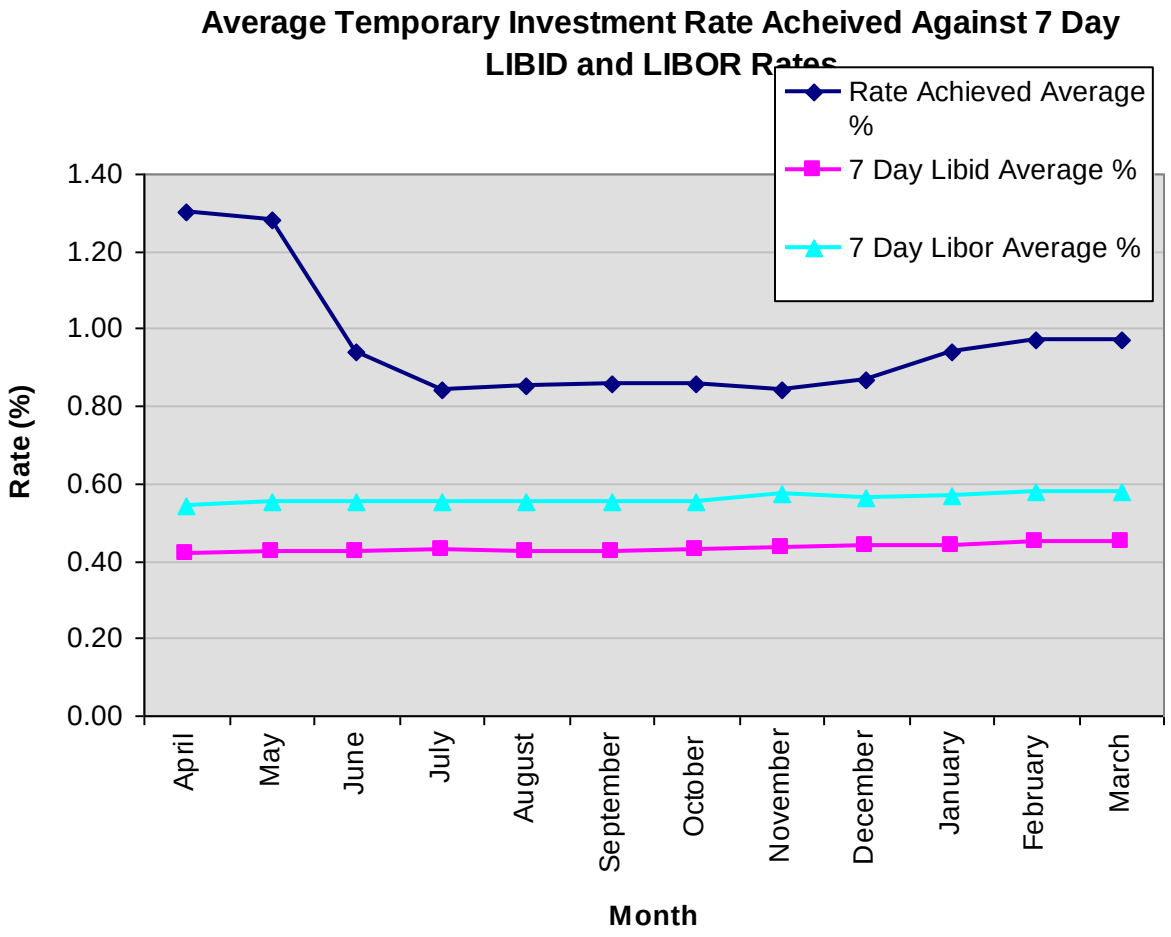
i) The total value of investments held at 31 March 2011, at amortised cost for money market investments and cash values for deposit accounts, was

£79.5m. All investments were placed with reference to the pre-determined lending list, in line with the investment strategy. The breakdown of investments at year-end is shown in the table below:

Investment Type	**Balance at 31 March 2011 £m**
Cash & cash equivalents	
Deposit and call accounts	21.4
Money Market Funds	5.0
Bank & Building Society investments up to 3 months	9.0
Current investments under 1 year	
Bank & Building Society investments < I year	38.1
Local authority investments < 1 year	6.0
Total	**79.5**

j) Most short-term investments were held for cashflow purposes. 77 money market investments were made during the year (excluding instant access deposit accounts). The range of investment periods was from 16 days to 364 days (1 year). The average investment period was 146 days.

k) The graph below shows the analysis of the Council's performance on investment returns by plotting the Council's average monthly investment rate achieved against the average 7 day London Interbank Bid Rate (LIBID), and the average 7 day London Interbank Offered Rate (LIBOR). More detail is shown at **Annex E**. The average rate achieved was above the target rates, at 0.96% compared to 0.43% LIBID, and 0.56% LIBOR. The differential to LIBID represents a value of £5,300 per £1m invested per annum.



l) A number of two year investments entered into in the first quarter of 2008, when interest rates were high, enabled the Council to achieve a significant variance above the LIBID rate at the beginning of the year. The Council's rate of return then fell as these investments matured and the funds were reinvested at prevailing lower rates. Performance stabilised during the mid part of the year at just above 0.4% over LIBID, rising to just over 0.5% over LIBID for the final quarter.

m) The Council does not hold any financial instruments listed or publicly traded on a stock exchange.

Performance Report - Debt Financing Budget Outturn

3.2.10 **Annex F** shows the budget, outturn and variance for the Council's debt and investment portfolio in 2010-11. This demonstrates the revenue (current) effects of the treasury transactions executed. A summary is set out below:

Budget Comparison	**Approved Budget 2010-11 £000**	**Outturn 2010-11 £000**	**Variance 2010-11 £000**
Debt Financing & Interest	2,358	879	(1,479)

The main features of the outturn variance are as follows:

- £1,117k backdated interest on a refund from HMRC on overpaid VAT in previous years
- £185k reduction in Minimum Revenue Provision (MRP) due to refinancing of capital expenditure in previous years from borrowing to capital receipts
- £183k over budget on interest earned on temporary investments (net of recharge for HRA cash balances) due to higher than budgeted cash balances and interest rates achieved.

Prudential Indicators and Treasury Management Indicators

3.2.11 Throughout the course of the year, the Council's treasury staff have monitored the prudential Indicators and the treasury management indicators set for 2010-11. The outturn indicators are shown at **Annex G.** Figures are shown at original (cash) value rather than amortised cost, in line with the requirements of the Prudential Code.

3.2.12 A technical breach of the treasury indicator for fixed rate interest rate exposure was reported to Council on 15 September 2011. This was due to the existing long term investments over 365 days falling out of the investment portfolio and being replaced with shorter term investments due to the prevailing economic conditions and interest rate environment. At the same meeting, the Council approved a change to the original indicator from zero to £10m for the remainder of 2010-11.

Compliance with agreed policies and practices, and statutory and regulatory requirements

3.2.13 The Council's officers and members have individual and collective responsibilities to comply with agreed policies and practices and statutory and regulatory requirements. These are set out in detail in the Schedules to the Council's Treasury Management Practices (TMPs). There were no recorded breaches of these responsibilities during 2010-11.

3.3 Choices (Options)

3.3.1 That the Portfolio Holder for Finance recommends to Council that they note the Council's Treasury Management Performance in 2010-11.

4. Implications (including financial implications)

4.1 Policy

4.1.1 The Council is required to adopt the latest CIPFA Treasury Management Code of Practice, and to set and agree the following policy and strategy documents:

a) A Treasury Management Policy Statement

b) Treasury Management Practices (TMPs) and TMP Schedules

c) An annual Treasury Strategy incorporating:

(i) The Capital Financing and Borrowing Strategy for the year including:

- The Council's policy on the making of Minimum Revenue Provision (MRP) for the repayment of debt, as required by the Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008.

- The Affordable Borrowing Limit for the year as required by the Local Government Act 2003.

(ii) The Investment Strategy for the year as required by the CLG Guidance on Local Government Investments issued in 2004, and updated in 2010.

d) A mid-year review report and an annual review report of the previous year.

With the exception of those at (d) above, these policy documents are reported to Cabinet and Council as part of the budget setting process. The Council's Treasury Strategy for 2010-11 was approved by Council at its meeting on 25 February 2010.

4.1.2 The updated CIPFA Treasury Management Code of Practice (published in 2009) required the Council to place greater emphasis on the scrutiny of treasury management strategies and policies. This includes the nomination of the body (such as an audit or scrutiny committee) responsible for ensuring effective scrutiny of the treasury management strategy, policies and practices. The Audit Committee has been nominated for this role, which includes the review of all treasury management policies and procedures, the review of all

treasury management reports to Cabinet and Council, and for making recommendations to Council.

4.2 Resources and Risk

4.2.1 The resources required for the Council's debt management and debt financing budgets are agreed annually through the Council's budget setting process. The debt financing budget outturn position is shown at paragraph 3.2.10 and **Annex F**.

4.2.2 The risk management of the treasury function is an integral part of day-to-day treasury activities. It is also specifically covered in the Council's Treasury Management Practices (TMPs), which are reviewed annually.

4.2.3 The risk implications of decisions taken and transactions executed during 2010-11 financial year are discussed in the body of the report at paragraph 3.2.6.

4.3 Legal

4.3.1 The Council is obliged to carry out its treasury management activities in line with statutory requirements and associated regulations and professional guidance. The relevant legislative and regulatory documents are referred to within the report and listed in the background papers.

4.4 Equality

4.4.1 An Equalities Impact Assessment was carried out on the Council's Treasury Strategy for 2010-11, and the associated Treasury Management Practices (TMPs) and the Schedules to the TMPs. This was included as an annex to the report to Cabinet on 24 February 2010 and to Council on 25 February 2010.

4.4.2 As a result of that assessment, it was noted that the potential impact of the strategy and associated documents (including Treasury Management Practices (TMPs) and the Schedules to the TMPs) on the different equalities groups must be considered as it is developed and put together each year. This includes the consideration of the potential impact on the different equalities groups of any processes, procedures or outcomes arising from these.

4.5 Consultees (Internal and External)

4.5.1 Consultation on treasury management matters is undertaken as appropriate with the Council's treasury advisor, Sector, and with the Portfolio holder for Finance.

4.5.2 Under the regulatory requirements, the Audit Committee has been nominated by Council as the body responsible for ensuring effective scrutiny of the treasury management strategy, policies and practices. This role includes the

review of all treasury management policies and procedures, the review of all treasury management reports to Cabinet and Council, and the making of recommendations to Council. Audit Committee reviewed and noted the draft Treasury Management Outturn 2010-11 report and annexes at their meeting on 25 July 2011.

4.6 How the Proposals deliver Priority Outcomes

4.6.1 The Council is required to keep its Treasury Management Strategy under review and monitor against it. The strategy should reflect the requirements of the CIPFA Code of Practice for Treasury Management in the Public Services.

4.6.2 This supports the Council's priority of providing quality services.

4.7 Other Implications

4.7.1 No other implications have been identified

5. Background Papers

5.1 Statute, Regulation and Guidance

- CIPFA Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes (Fully Revised Second Edition) 2009
- Local Government Act 2003
- Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2010
- CIPFA Prudential Code for Capital Finance in Local Authorities (Fully Revised Second Edition) 2009
- ODPM Guidance on Local Government Investments 2004
- CIPFA Treasury Management in the Public Services - Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (Fully Revised Third Edition) 2009
- CIPFA Prudential Code for Capital Finance in Local Authorities – Fully Revised Guidance Notes for Practitioners 2007
- Audit Commission. Risk & Return: English Local Authorities and the Icelandic Banking Crisis (March 2009)
- CLG Select Committee report on Local Authority Investments (11 June 2009)
- The Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008
- CLG Guidance on Local Government Investments (11 March 2010)
- CIPFA Code of Practice on Local Authority Accounting in the United Kingdom 2010-11

5.2 Reports to Cabinet & Council

- Treasury Management Outturn 2009-10 – Member decision report to Portfolio Holder for Finance 1 September 2010 & Council 13 September 2010

- Treasury Strategy 2010-11 to 2012-13 – Report to Cabinet 24 February 2010 & Council 25 February 2010 (Contains formal adoption of the fully revised second edition of CIPFA Code of Practice for Treasury Management)
- Treasury Management Mid Year Report 2010-11 – Report to Cabinet 15 December 2010 & Council 17 January 2011
- Treasury Strategy 2011-12 to 2013-14 – Report to Cabinet 23 February 2011 & Council 28 February 2011

5.3 Reports to Audit Committee

- Treasury Management Outturn 2010-11 – Report to Audit Committee 25 July 2011

Bev Dixon, Finance Manager – Treasury, ext 7401
Isabell Procter, Director of Finance & support ext 8757