AUDIT COMMITTEE – 27 JULY 2012

Title of paper:	**TREASURY MANAGEMENT ANNUAL REPORT 2011/12**	
Director(s)/ Corporate Director(s):	**Report of Director of Strategic Finance**	**Wards affected: All**
Report author(s) and contact details:	Tony Kirkham ☎ 0115 8763132 ✉ tony.kirkham@nottinghamcity.gov.uk	
Other colleagues who have provided input:	Members of Treasury Management Panel: Tony Kirkham, Director of Strategic Finance Jeff Abbott, Head of Strategic Finance Geoff Walker, Strategic Finance Manager Peter Guest, Treasury Management Officer	

Relevant Council Plan Strategic Priority: (you must mark ✓ in the relevant boxes below)	
World Class Nottingham	✓
Work in Nottingham	✓
Safer Nottingham	✓
Neighbourhood Nottingham	✓
Family Nottingham	✓
Healthy Nottingham	✓
Leading Nottingham	✓

Summary of issues (including benefits to citizens/service users):

This report sets out the 2011/12 performance in respect of treasury management - the management of the Council's external debt and investments.

Recommendation(s):

1	Audit Committee consider and comment on the Treasury Management 2011/12 Annual report, shown at **Appendix A**.

1. BACKGROUND

Treasury management is the management of an organisation's borrowings and investments, the effective management of the associated risks and the pursuit of optimum performance or return consistent with those risks.

The treasury management function is governed by provisions set out under Part 1 of the Local Government Act 2003, whereby the City Council must have regard to the CIPFA Prudential Code and the CIPFA Code of Practice. Under the latter Code, an annual report is required to be submitted to and considered by councillors.

The 2011/12 annual report is shown at **Appendix A** for information. This report was considered by Executive Board on 19 June 2012.

2. REASONS FOR RECOMMENDATIONS (INCLUDING OUTCOMES OF CONSULTATION)

Recent changes to the Code require authorities to nominate a body within the organisation to be responsible for scrutiny of treasury management activity. It is considered that the City Council's Audit Committee is the most appropriate body for this function. In undertaking this, the Audit Committee will be responsible for the effective scrutiny of treasury management policies and practices

3. OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

Options for management of the Council's debt and investment portfolio are continually reviewed. The overall aim is to minimise the net revenue costs of our debt whilst maintaining an even debt profile in future years, and to maximise investment returns within stated security and liquidity guidelines.

4. FINANCIAL IMPLICATIONS (INCLUDING VALUE FOR MONEY/VAT)

Details of the financial implications associated with treasury management activity in 2011/12 are provided in **Appendix A, section 5.**

5. RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS AND CRIME AND DISORDER ACT IMPLICATIONS)

Risk management plays a fundamental role in treasury activities, due to the value of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is maintained for the treasury function.

6. EQUALITY IMPACT ASSESSMENT

Has the equality impact been assessed?

Not needed (report does not contain proposals or financial decisions)	✓
No	☐
Yes – Equality Impact Assessment attached	☐

7. LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

PWLB records, working papers 2011/12

8. PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

CIPFA statistics, LIBID rates 2011/12

APPENDIX A

EXECUTIVE BOARD - 19 JUNE 2012

Title of paper:	Treasury Management Annual Report 2011/12	
Director(s)/ Corporate Director(s):	Director of Strategic Finance	**Wards affected:** All
Portfolio Holder(s):	Cllr Graham Chapman – Deputy Leader and Portfolio Holder for Economic Development, Resources and Customer Care	**Date of consultation with Portfolio Holder(s):** Throughout 2011/12 and specifically in May 2012
Report author and contact details:	Tony Kirkham ☎ 0115 8763132 ✉ tony.kirkham@nottinghamcity.gov.uk	
Others who have provided input:	Tony Kirkham, Director of Strategic Finance Jeff Abbott, Head of Strategic Finance Geoff Walker, Strategic Finance Manager Peter Guest, Treasury Management Officer	

Key Decision:	No
Reasons for Key Decision:	
Expenditure of £1,000,000 or more in a single year	
Revenue income of £1,000,000 or more in a single year	
Savings of £1,000,000 or more in a single year	
Capital expenditure of £1,000,000 or more	
Capital income of £1,000,000 or more	
To be significant in terms of its effects on communities living or working in an area consisting two or more wards in the City	

Relevant Council Plan theme(s):	
World Class Nottingham	✓
Work in Nottingham	✓
Safer Nottingham	✓
Neighbourhood Nottingham	✓
Family Nottingham	✓
Healthy Nottingham	✓
Leading Nottingham	✓

Summary of issues (including benefits to customers/service users):

This report sets out the 2011/12 performance in respect of the management of the Council's external debt and investments (i.e.: treasury management). The key issues are:

- The average rate of interest payable on external debt reduced from 4.120% at 1 April 2011 to 3.740% at 31 March 2012 (see section 3.3).
- The average rate of interest earned on short-term investments in 2011/12 was 1.038%. This is benchmarked against the 7 day London Inter-bank (LIBID) rate provided by the Bank of England, which averaged 0.521% for the same period (see section 3.6).
- The 2011/12 out-turn showed net General Fund expenditure of £31.2m (see section 5.1)

Recommendation(s):

1	It is recommended that the performance information in this annual treasury management report be noted.

1 BACKGROUND

1.1 Treasury Management entails the management of the Council's cash flows, its borrowings and investments, the management of the associated risks and the pursuit of the optimum performance or return consistent with those risks. To assist in this process the Council retains external financial advisors.

2 REASONS FOR RECOMMENDATIONS (INCLUDING OUTCOMES OF CONSULTATION)

2.1 The Council adopted the Chartered Institute of Public Finance and Accountancy (CIPFA)'s revised Code of Practice on Treasury Management in Local Authorities (the Code) on 18 February 2002. Part of the Code requires a formal annual report on the performance of the Treasury Management function.

3 TREASURY MANAGEMENT ACTIVITY IN 2011/12

3.1 External advisors

External advisors (Arlingclose) are retained to provide additional input on treasury management matters. The service comprises economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy and credit ratings and technical assistance on other matters, as required.

3.2 Prudential Indicators

Following the Local Government Act 2003, the Council is required to approve a series of treasury management prudential indicators. **Appendix 1** shows actual performance against these indicators for 2010/11 and 2011/12 - enabling comparison. The final column in the table reflects actual outturn against targets. For the affordability and treasury management indicators, this indicates whether the outturn was within set limits. For the prudence indicators, the actuals reflect the management of the capital programme and associated debt, within existing resource limitations. All of the outturn indicators at 31 March 2012 are within the parameters set for the year and there were no breaches of limits during the year.

The' PFI and leasing debt' figures within the indicators reflect the notional debt element of those schemes financed through Private Finance Initiative funding or finance leases. These have reduced in the year by £165m, largely because the existing Nottingham Express Transit contract was terminated as part of the tram network development programme, with related debt being repaid (see 3.6 below).

3.3 Loan debt portfolio

Total outstanding debt during 2011/12 increased by £195.811m to £754.956m at 31 March 2012. The average rate of interest on that debt fell from 4.120% at 1 April 2011 to 3.740% at 31 March 2012. The majority of long-term borrowing is raised from the Government's Public Works Loans Board (PWLB). **Table 1** analyses the debt portfolio:

TABLE 1: DEBT PORTFOLIO				
	1 APRIL 2011		31 MARCH 2012	
DEBT	**£m**	**%**	**£m**	**%**
PWLB borrowing	456.0	4.470	628.0	4.073
Market loans	51.3	4.287	51.3	4.287
Local bonds	1.7	2.782	1.0	2.417
Temporary borrowing	50.1	0.807	74.7	0.574
TOTAL DEBT	**559.1**	**4.120**	**755.0**	**3.740**

Good treasury management practice requires a spread of maturing debt over future years, avoiding large amounts of debt falling to be repaid in any one year. Prudential indicators include a requirement for fixed debt maturity to be within set parameters. **Table 2** shows those parameters and the actual debt percentages at 31 March 2012.

TABLE 2: DEBT MATURITY ANALYSIS		
Period of loan	**Parameters** %	**Actual 31 Mar 2012** %
Under 12 months	0 – 20	15.65
1 to 2 years	0 – 20	4.30
2 to 5 years	0 – 25	4.30
5 to 10 years	0 – 25	16.17
10 to 25 years	0 – 50	30.40
25 to 40 years	0 – 25	11.10
> 40 years	0 - 75	18.08

The debt maturity profile is reviewed as part of the overall review of treasury management strategy.

3.4 Economic background

When the 2011/12 strategy was approved, in March 2011, there were some signs that the austerity measures introduced in the 2010 Comprehensive Spending Review were leading to a slow recovery from recession in the UK, although the Eurozone sovereign debt problems remained a potential barrier to that recovery.

The final outcome for 2011/12 has not seen those expectations realised, with a further period of recession now being experienced. Debt problems in Europe became critical, with bail-out packages for Greece and Portugal announced. The ECB also injected around €1.3 trillion into financial markets to relieve the immediate funding pressure for European banks, although this was generally viewed as delaying matters rather than addressing fundamental problems.

Total UK growth for 2011 amounted to only 0.50% (from an original estimate of 1.50%), whilst inflation rates and unemployment figures have remained high. The base interest rate has been held at 0.50% since March 2009, with little expectation of any increases in the near future. Notwithstanding this, the Government are maintaining their position on the austerity plans introduced in the UK at present.

As a consequence of the above, UK government bond (gilt) prices increased and yields fell, as the UK's AAA credit rating ensured that such gilts remained an attractive 'safe haven' for investors. This has led to a reduction in PWLB borrowing rates, which are linked to gilt yields, for all periods. At the same time, the credit ratings of a number of UK and European financial institutions were downgraded during the year, as the prospect of future sovereign support for banks was reviewed.

3.5 Strategy during year

The overall Treasury Management strategy for 2011/12 was approved at a meeting of the Council on 7 March 2011 and included:

- *new borrowing*

A borrowing requirement of £53.1m was estimated for 2011/12, to replace maturing debt and finance capital expenditure. The type, period, and timing of new borrowing would be dependant on the expected movement in interest rates and the existing debt maturity profile, as well as approved prudential indicators and limits. The continued use of existing surplus cash to fund the borrowing requirement (‘internal borrowing’) would remain an option, given projected interest rates.

- *rescheduling*

Rescheduling of debt (the early repayment of existing loans and the replacement of that debt with new borrowing for different periods) is undertaken to improve the maturity profile of outstanding debt and reduce the interest charge on the revenue account. It was intended to take advantage of such opportunities if and when they arose during the year.

- *investments*

Cash surpluses during the year would be invested with security and liquidity being the primary driver. Within those stated guidelines, the interest earned would be maximised. Investment activity would follow the specific approach included within the Treasury Management strategy report. The use of such surpluses to fund the borrowing requirement, on a temporary basis, would continue where appropriate.

3.6 Performance

Performance on the various elements within the adopted treasury management strategy during 2011/12 (see 3.5) is set out below:

- *Overall borrowing strategy*
  In 2010/11, surplus cash was used to suppress the need for new borrowing, because of the margins between long-term borrowing costs and short-term investment returns. This strategy generated significant revenue savings and was continued in 2011/12. At 31 March 2012, the margin between actual external borrowing and the borrowing need (the Capital Financing Requirement) rose to around £82m. Advantage was also taken during 2011/12 to raise cheap shorter-term loans from other local authorities, to meet cash flow requirements.

- *New borrowing*
  There was no new long-term borrowing raised in 2011/12, other than the specific PWLB loan to finance the development of the Nottingham Express Tram (NET) scheme network, detailed below. Net short-term borrowing rose by £24m.

- *NET loan*
  The extension of the tram network, through a new contract for the operation of Line One together with the construction of Lines 2 and 3, was approved by Executive Board on 19 July 2011 and completed in December 2011. With the appointment of a new concessionaire to operate the network, it was necessary to terminate the existing Line One contract. The cost of this termination was met from a single PWLB loan totalling £250m, raised in December 2011, with future interest and principal costs being met from government PFI grant and Workplace Parking Levy income streams.

- *HRA debt repayment*
  In March 2012, as part of the Government’s housing finance reforms, City Council PWLB debt totalling £66m was repaid by HM Treasury. This was provided in compensation for the cessation of housing subsidy, previously receivable by the Council, from 1 April 2012. The debt repayment will reduce the Housing Revenue Account element of the debt portfolio and consequently its future interest charges.

- *Other repayments / rescheduling*
  During 2011/12, there was little opportunity for any rescheduling of PWLB debt, largely as a result of the Government's decision to maintain a significant margin between debt repayment rates and new borrowing rates. Opportunities to reschedule some of the existing market loans were investigated but proved uneconomic to pursue.

- *Investments*
  Investments of surplus cash, generated from a combination of core cash, short-term surpluses and various reserves and provisions, were made throughout the year, in line with the strategy approved by Council in March 2012.

  The counterparty list is based on the approved financial institution achieving a minimum specified credit rating, with the lowest rating from the three rating agencies being applied. Other factors, such as share prices, Credit Default Swap rates, sovereign credit ratings and support mechanisms and market sentiment are also considered. Monitoring of all these elements is carried out by the Council and by its advisors, on a daily basis.

  During the year, changes in the perceived security of a number of financial institutions, largely following reductions in individual credit ratings, led to changes in the investment strategy. Reports to Council were approved in October, to increase the maximum sums to be placed in Money Market Funds (pooled, liquid high quality investment products, offering instant access), and in December, to reduce the minimum investment criteria, allowing the continued investment in UK banks where government support was considered most likely.

- *overall investment performance*
  The average level of sums invested during the year was £135m, earning total interest of £1.401m at an average rate of 1.038%. The Council benchmarks its average return against the 7-day London Inter-bank (LIBID) rate provided by the Bank of England. For 2011/12 the average LIBID rate was 0.521%.

- *Icelandic bank deposits*
  In October 2008, the Icelandic banking system failed, resulting in the collapse of its four major banks. At that time, the Council had a total of £41.6m deposited with three of those banks - Glitnir, Landsbanki and Heritable.

  The administration process to determine the level of repayments to be made to the banks' various creditors, which started in 2009, continued throughout 2011/12. A significant landmark occurred in October 2011, when the Icelandic Supreme Court affirmed that all UK Local Authority depositors in the Iceland-based Glitnir and Landsbanki banks would be afforded priority creditor status. This meant that for those two banks, it was expected that 100% of the value of the original sums deposited would be recovered.

  The expected final repayment levels, based on the latest reports from the various bank administrators, is shown in **Table 3**:

TABLE 3: ICELANDIC BANK DEPOSITS		
Bank	**Deposit £m**	**Recovery %**
Glitnir	11.0	100
Landsbanki	15.0	100
Heritable	15.6	88
TOTAL	**41.6**	

At 31 March 2012, the Council had recovered a total of £23.7m of its original deposits, plus a further £0.9m in interest. Based on the final estimated percentage returns in **Table 3** above, the total principal sum recovered will be £39.7m, plus £1.6m interest, although the final repayment is not currently scheduled to be received until 2018. Provision for the financial loss (impairment) associated with these deposits was made in 2010/11, from the Treasury Management Reserve.

- *daily cash management*

To avoid bank overdraft charges and maximise interest earned, the Council seeks to maintain an overnight cash balance between - £300k and + £150k. The target for 2011/12 was 99%, with an actual rate of 98.86% being achieved.

4 OTHER OPTIONS CONSIDERED IN MAKING RECOMMENDATIONS

Options for management of the Council's debt and investment portfolio are continually reviewed. The overall aim is to minimise the net revenue costs of our debt whilst maintaining an even debt profile in future years, and to maximise investment returns within stated security and liquidity guidelines.

5 FINANCIAL IMPLICATIONS (INCLUDING VALUE FOR MONEY)

5.1 General Fund Revenue Implications

Revenue costs associated with borrowing and lending tend to be volatile, being affected by a number of factors, including movements in interest rates, the timing of capital spending, the extent of reserves held and actual cash flows during the year.

Total treasury management-related costs in 2011/12, comprising interest charges less receipts, plus provisions for repayment of debt, were £39.710m. A significant proportion of the Council's debt relates to capital expenditure on council housing and £11.795m was recharged to the Housing Revenue Account (HRA) and funded through the Housing Subsidy system. The remaining costs were included within the treasury management section of the General Fund budget. Actual General Fund expenditure for 2011/12 was therefore £27.915m.

The original budget provided for a contribution into the Treasury Management Reserve of £3.3m, to allow for an unfavourable outcome to the Icelandic Bank administration process, and this contribution has been retained. In addition, the gross impairment provision, previously met from the Treasury Management Reserve, was reduced by £2.2m in 2011/12, as a result of the improved forecasted recovery rates and the notional interest credited to the revenue account in the year. This sum has also been transferred to the Reserve, to offset the gross impairment provision previously provided therein.

The final General Fund position for 2011/12 is summarised in **Table 4:**

TABLE 4: GENERAL FUND TREASURY MANAGEMENT COSTS 2011/12		
DESCRIPTION	**BUDGET 2011/12 £m**	**OUTTURN 2011/12 £m**
External interest	26.096	25.869
Debt repayment provision	16.631	16.149
Prudential borrowing recharge	(1.303)	(0.678)
Investment interest	(1.719)	(1.401)
Other interest	(0.166)	(0.229)
Less: HRA recharge	(11.629)	(11.795)
Net Treasury Management costs	**27.910**	**27.915**
Net impairment charge – change in year	-	(2.120)
General Fund expenditure	**27.910**	**25.795**
Treasury Management Reserve transfer	3.310	5.425
NET GENERAL FUND POSITION	**31.220**	**31.220**

5.2 Treasury Management Reserve

The Treasury Management Reserve is maintained to smooth the impact of any volatility in treasury management revenue charges in any one year. The balance on the Reserve at 1 April 2011 was £1.450m. The effect of the transfer in 2011/12 is to increase the balance to £6.875m. With the expected satisfactory resolution of the recovery of Icelandic Bank deposits, consideration will be given to the treatment of this Reserve in future years.

5.3 Value for Money

Management of borrowing and investments is undertaken in conjunction with our appointed advisors, with the aim of minimising net revenue costs, maintaining an even debt maturity profile and ensuring the security and liquidity of investments.

6 RISK MANAGEMENT ISSUES (INCLUDING LEGAL IMPLICATIONS AND CRIME AND DISORDER ACT IMPLICATIONS)

Risk management plays a fundamental role in treasury activities, due to the value of transactions involved. The management of specific treasury management risks is set out in the Manual of Treasury Management Practices and Procedures and a risk register is maintained for the treasury function.

7 EQUALITY IMPACT ASSESSMENT (HAS AN EQUALITY IMPACT ASSESSMENT BEEN CARRIED OUT?)

No – this report does not include proposals for new or changing policies, services or functions.

8 LIST OF BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING CONFIDENTIAL OR EXEMPT INFORMATION

Final ledgers, working papers 2011/12.

9 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

CIPFA statistics, LIBID rates 2011/12

PRUDENTIAL INDICATORS **Appendix 1**

INDICATORS	2010/11 Actual	2011/12 Estimate	2011/12 Actual	Within Limits?
1) Prudence indicators **i) Capital Expenditure**				
General Fund	£131.9m	£ 454.1m	£ 347.5m	YES
HRA	£56.9m	£ 55.3m	£ 58.0m	YES
	£188.8m	**£ 509.4m**	**£ 405.5m**	
ii) CFR at 31 March General Fund	£294.2m	£ 608.2m	£ 552.4m	YES
HRA	£323.3m	£ 341.7m	£ 284.3m	YES
PFI notional 'debt'	£175.6m	£ 233.8m	£ 59.1m	N/A
	£793.1m	**£1,183.7m**	**£ 895.8m**	
iii) External Debt at 31 March Borrowing	£559.1m	£ 890.9m	£ 755.0m	YES
PFI & leasing notional 'debt'	£175.6m	£ 233.8m	£ 59.1m	N/A
Gross debt	**£734.7m**	**£1,124.7m**	**£ 814.1m**	
Less investments	£(153.8)m	£ (146.0)m	£ (166.3)m	N/A
Net Debt	**£580.9m**	**£ 978.7m**	**£ 645.4m**	
2) Affordability indicators **i) Financing costs ratio**				
General Fund	7.73%	8.95%	9.81%	YES
HRA	12.17%	12.18%	12.77%	YES
Council Tax Band D (per annum)	-	-	-	YES
HRA rent (per week)	-	-	-	YES
			Max in year	
iii) Authorised limit for external debt	£815.3m	£1,243.9m	£823.4m	YES
iv) Operational limit for ext. debt	£812.3m	£1,218.9m	£823.4m	YES
3) Treasury Management indicators	%	%	**@ 31/3/12**	
ii) Limit on variable interest rates	14.91	0-50%	9.99%	YES
iii) Limit on fixed interest rates	85.09	50-100%	90.01%	YES
iv) Fixed Debt maturity structure				
- Under 12 months	11.26	0-20%	15.65	YES
- 12 months to 2 years	7.07	0-25%	4.30	YES
- 2 to 5 years	5.76	0-25%	4.30	YES
- 5 to 10 years	15.06	0-25%	16.17	YES
- 10 to 25 years	18.28	0-50%	30.40	YES
- 25 to 40 years	6.44	0-25%	11.10	YES
- 40 years and above	36.13	0-75%	18.08	YES
			Max in year	
v) Max sum invested for >364 days	£33.8m	£40m	£28.2m	YES