MUNICIPAL YEAR 2012/2013 REPORT NO. 80

Agenda – Part: 1	Item: 13
Subject: **ANNUAL TREASURY MANAGEMENT OUTTURN REPORT 2011/12** **Wards: All**	
Cabinet Member consulted: Cllr. A. Stafford	

MEETING TITLE AND DATE:
Council
19th September 2012

REPORT OF:
Director of Finance, Resources
& Customer Services

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1. EXECUTIVE SUMMARY

1.1 This report reviews the activities of the Council's Treasury Management function over the financial year ended 31 March 2012.

1.2 The key points of the report are highlighted below:

		See section:
Borrowing taken out to finance HRA self-financing regime	• *A 50 year PWLB loan of £28.79 million at a fixed interest rate of 3.48%.*	***6***
Debt Outstanding at year end to finance capital	• *Four one year loans totalling £20 million at an average rate of 1.22%*	***8***
Average interest on total debt outstanding	• The average interest rate on borrowing fell to 4.99%	**8**
Debt Re-scheduling	• *None undertaken*	**9**
Interest earned on investments	• *Outperformed the 7 day bank rate by 0.31%*	**11**
Net Borrowing	• *Net borrowing (difference between total debt & investments): 221 million. An increase of £32 from 2010/11.* • *The Council adopted the strategy of using its investment balances to finance capital expenditure instead of borrowing externally.*	**11**

2. RECOMMENDATIONS

2.1 Council is recommended to accept the Treasury Outturn report. .

3. BACKGROUND

3.1 The Council adopted the CIPFA Revised Treasury Management Code of Practice and approved the annual Treasury Management Policy Statement in February 2010.

3.2 The statement requires the Director of Finance Resources & Customer Services to report to Council on the preceding year's treasury management activities. In accordance with best practice, the Director's report includes information about borrowing levels and costs, as well as the impact of the cash flow management arrangements on the Council's financial position.

4. NATIONAL CONTEXT

4.1 At the time of determining the 2011/12 strategy in *Feb* 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%> Unemployment was at a 16-year high at 2.5 million and was expected to rise further as the public and private sector contracted. There was a also high degree of uncertainty surrounding Eurozone sovereign debt sustainability.

4.2 Monetary Policy: the Bank of England's 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.

4.3 The policy measures announced in the March 2012 Budget statement were judged to be neutral. The government stuck broadly to its austerity plans as the economy was rebalancing slowly. The opinion of independent Office for Budget Responsibility (OBR) was that the government was on track to meet its fiscal targets; the OBR 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.

5. THE HERITABLE BANK IMPAIRMENT

5.1 Heritable Bank (a UK financial institution) went into administration on 7th October 2008 as a direct result of its Icelandic parent Landbanki bank failing. The Authority held a £5 million deposit. This investment was made on 9th January 2008 for 364 days.

5.2 Since that date the Council has been vigorously chasing recovery of our funds and has lodged claims with the Heritable Bank administrator. Since this time the Authority has received regular distributions as set out below.

Table 1: Dividends on Heritable Bank	**Pence in the pound**	**£000s**
Total received as at 1st April 2011	**50.27**	**2,607**
Received in April 2011	6.27	325
Received in July 2011	4.07	211
Received in October 2011	4.20	218
Received in January 2012	3.33	173
Total received as at 31st March 2012	**68.14**	**3,534**

5.3 In April 2012 the Authority received a dividend of £197k (3.8p) and a further payment in July of £148k (2.9p) taking the total recovered to £3.879m representing 75% of the total investment (including interest).

5.4 The Administrator has increased his projection of the return of capital up to 90% but is still based on cautious assumptions. This is very encouraging given the continuing difficult market conditions. Nevertheless, the Council will pursue all avenues to ensure the full deposit and interest are recovered.

6 HRA SELF-FINANCING

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6.1 The Localism Act passed into law in November 2011 which enabled the reform of council housing finance. The Housing Revenue Account 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 readjustment 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. Settlement date for the Self Financing transaction was Wednesday 28th March 2012

6.2 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 £28.79m.

6.3 This required the Council to fund the settlement through borrowing. A preferential set of PWLB rates at 13bps above the equivalent gilt yield were available for this transaction on 26th March only, for settlement on 28th March. 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 £28.79m through new borrowing from the PWLB

6.4 Loan structures and maturities were discussed and analysed with the Council's Treasury Advisors to fit in with the Council's HRA business plan and strategy, funding costs, as well as the Council's existing treasury management position and risk profile. Details of the loans borrowed are in *section 6*, below. The Council will continue to work with its Treasury Advisors and Housing Consultants to manage the HRA Business Plan and accounting implications going forward

7 BORROWING IN 2011/12

7.1 As outlined in the previous section the Council borrowed £28.79m at an interest rate of 3.48% for 50 years it simultaneously paid the £28.79m to the DCLG so there was no impact on the Council's cash flow position. All of the interest costs on the new loan will be borne by the HRA.

7.2 The Council did borrow £20 million in loans with a maturity of a year at an average rate of 1.2%. Given the low interest rate, these loans gave good value in comparison to the longer term rates.

7.3

Table 2: Movement in year	**Debt 1 April 2011**	**Debt Repaid**	**New Debt Raised**	**Debt 31 March 2012**
	£000	**£000**	**£000**	**£000**
Temporary Borrowing	2,800	(2,800)	20,000	20,000
	2,800	**(2,800)**	**20,000**	**20,000**
Public Work Loan Board loans (PWLB)	185,347	-	28,790	214,137
Commercial Loan	30,000	-	-	30,000
	215,347	**-**	**28,790**	**244,137**
Total Debt Outstanding	**218,147**	**(2,800)**	**48,790**	**264,137**

7.4 The Council's Treasury Management strategy continues to follow the same direction as it set since the financial collapse in October 2008, whereby capital expenditure is funded wherever possible by using the Council's internal cash reserves. This has a beneficial impact on the interest charges because of the large differential between long-term fixed borrowing and the interest rate in short term investments meant the 'cost of carry' would have been approximately 4%.

7. INTEREST ON TOTAL DEBT OUTSTANDING

7.1 The average rate paid on total external debt was 5.31% in 2011/12 (5.51% 2010/11).

7.2 Table 3 shows the interest paid (i.e. the cost of borrowing) by the Council during the year:

7.3

Table 3: Cost of Borrowing	**2011/12**	**2010/11**
	£000	**£000**
Public Work Loan Board loans (PWLB)	9,822	9,992
Commercial Loans	2,143	2,143
Total Interest on Debt	**11,965**	**12,135**
Short Term Loans	155	-
Total interest paid	**12,120**	**12,135**
Interest Premiums	276	355
Total Cost of Debt	**12,396**	**12,490**
Cost Attributed to the HRA	4,333	3,642
Cost Attributed to General Fund	8,063	8,848
	12,396	**12,490**

7.3 Due to the additional capital expenditure for Affordable Homes, the HRA proportion of total borrowing increased during 2011/12.

8. DEBT MATURITY STRUCTURE

8.1 The Council has 33 loans spread over 48 years with the average maturity being 38 years. This maturity profile allows the Council to spread the risk of high interest rates when debt matures in any one year.

8.2 Table 4 shows the maturity structure of Enfield's long-term debt and the average prevailing interest rates.

Table 4: Profile Maturing Debt	Debt Outstanding as at 31 March 2012	Average Interest Rate	Debt Outstanding as at 31 March 2011	Average Interest Rate
Years	**£000**	**%**	**£000**	**%**
Under 1 year	20,000	1.22	2,800	0.5
1-5	-	-	-	-
5-10	31,000	7.40	30,000	7.14
10-15	-	-	1,000	15.12
15-25	20,070	5.50	20,070	5.50
25-40	103,278	5.42	62,757	5.38
40-45	45,000	6.51	85,520	5.35
45-50	44,789	3.81	16,000	4.40
	264,137	**4.99%**	**218,147**	**5.51%**

9. DEBT RESTRUCTURING

9.1 Debt restructuring normally involves prematurely replacing existing debt (at a premium or discount) with new loans in order to secure net savings in interest payable or a smoother maturity profile. Restructuring can involve the conversion of fixed rate interest loans to variable rate loans and vice versa.

9.2 No debt restructuring was undertaken during the year. We will continue to actively seek opportunities to re-structure debt over 2012/13.

10. TREASURY MANAGEMENT PRUDENTIAL INDICATORS: 2011/12

10.1 Throughout 2011/12 total loan debt was kept within the limits approved by the Council at its meeting in March 2012 against an authorised limit of £500 million and an operating limit of £400 million. The authorised limit (as defined by the Prudential Code) was set at £500 million as a precaution against the failure, for whatever reason, to receive a source of income e.g. Council Tax. In the unlikely event of this happening, the Council would need to borrow on a temporary basis to cover the shortfall in cash receipts. In practice it is the operating limit by which the Council monitors its borrowing; any significant breach must be reported to Council.

10.2 The Council held no variable interest rate debt during 2011/12. The Council's Prudential Code however does allow for up to 25% of the debt to be held in variable interest rate debt.

10.3 The Prudential code allows up to 15% of its debt to mature in one year (£33 million). This limit was not breached.

11. INVESTMENTS

11.1 The Council manages its investments arising from cash flow activities in-house and invests within the institutions listed in the Authority's approved lending list. It can invest for a range of periods approved in the Annual Treasury Strategy Report.. The Council acts as the treasury manager for the 79 Enfield schools within the HSBC banking scheme and Enfield Homes. The Council produces a three year cash flow model (based on daily transactions) which projects the cash flow movements of the Council linked into the Council's medium term financial plan. This allows the Treasury Management team to make more informed decisions on borrowing and lending.

11.2 In 2011/12 the Council received £0.6 million in interest on money lent out to the money markets a reduction of £0.2m from 2010/11. The average cash balance held by the Council during the year was £67 million (see Appendix 2) compared to £89 million in 2010/11. This is set out in table 5 below:

Table 5: Interest Receipts	**2011/12 £000**	**2010/11 £000**
Total Interest Receipts	**583**	**764**
Interest paid to HRA	(81)	(111)
Interest paid to Enfield Homes	(8)	(13)
Section 106 Applications	(24)	(21)
Other Funds	(23)	(41)
Total Interest to General Fund	**447**	**578**

11.3 Table 6 shows the maturity structure of Enfield's investments and the prevailing interest rates. The Authority continues to adopt a very prudent approach and but deposits are still restricted to a number of highly rated banks and money market funds. The table shows that during the year the Council adopted a more restrictive approach to cash investments and by year end due to the financial uncertainties caused by the euro-crisis the Council had reduced its maximum deposit duration to 3 months and had reduced its maximum limits with anyone approved bank or money market fund. List of banks where deposits are held is set out in Appendix 1.

Table 6: Maturing Investments	**Investments as at 31 March 2012**	**No of Deals**	**Investments as at 31 March 2011**	**No of Deals**
Months	**£000's**		**£000's**	
On demand	37,900	7	-	-
Within 1 month	-	-	7,500	1
Within 3 Months	5,700	1	5,000	1
Within 6 Months	-	-	5,000	1
Within 9 Months	-	-	12,500	2
Within 12 Months	-	-	-	-
Over 12 Months	-	-	-	-
	43,600	**8**	**30,000**	**5**

11.4 The Treasury Management team achieved an average interest rate of 0.86%, out-performing the benchmark (Inter-Bank 7-day lending rate 0.55%). This was achieved by adopting an active treasury policy.

Net Borrowing

11.6 The Council's net borrowing increased in 2011/12 as Table 7 demonstrates the cost of the Council's capital programme over the year, however the position is distorted by the Council having to take out a loan £28.8m to finance the new HRA regime . The increase on net borrowing reflects the fact that the Authority took the decision to fund the 2011/12 capital programme. The strategy of using internal borrowing to finance the 2011/12 capital programme saved the Council approximately £1.5 million in the year. However, the cash reserves are now at a low level and therefore, cannot be used to finance capital expenditure. Future capital expenditure will need to be financed from borrowing, which will create pressure on the revenue budget but this impact as been recognised in the Council's Medium term financial plan.

Table 7: Trend in Net Borrowing	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**
	£000	**£000**	**£000**	**£000**	**£000**
Total Borrowing	242,043	220,347	220,347	218,347	264,136
Total Investments	(178,500)	(123,100)	(74,150)	(30,000)	(43,600)
Net Borrowing	**63,543**	**97,247**	**146,197**	**188,347**	**220,536**
Annual increase in borrowing		**33,704**	**48,950**	**42,150**	**32,189**

The Capital Financing Requirement reflects the Council's underlying need to borrow to fund its capital programme (Table 8).

Table 8: Capital Financing Requirement	**As at 31st March 2012**
	£000's
General Fund	250,548
Housing Revenue Account	157,728
Total	**408,276**

The Council is allowed to borrow up to its capital financing requirement which means it has £144.14m headroom to increase it's borrowing.

11.7 Through careful cash management control (i.e. the ability to accurately predict the daily out/in flows of cash) the Treasury Management team have limited the Council's overdraft costs in the year to £106.

11.8 Appendix 3 sets out our external auditor's review of the Council's arrangements for securing financial resilience. It is pleasing to note the report verifies that the Council has strong financial controls and monitoring in place.

13. ALTERNATIVE OPTIONS CONSIDERED

13.1 None. This report is required to comply with the Council's Treasury Management Policy statement, agreed by Council in February 2003.

14. REASONS FOR RECOMMENDATIONS

14.1 To inform the Council of Treasury Management performance in the financial year 2011/12.

15. COMMENTS OF THE DIRECTOR OF FINANCE & CORPORATE RESOURCES

15.1 **Financial Implications**

Financial implications are set out in the body of the report.

15.2 **Legal Implications**

The Council has a statutory duty to ensure the proper administration of its financial affairs and a fiduciary duty to tax payers to use and account for public monies in accordance with proper practices.

The Statement has been prepared in accordance with the CIPFA Code of Practice.

15.3 **Key Risks**

Extending the maximum period of deposits will increase the level of risk of default. This fact must be considered against backdrop that investments will still be restricted to countries with a sovereign rating of AAA and that deposits will be made only with financial institutions with a high credit rating.

16. IMPACT ON COUNCIL PRIORITIES

16.1 Fairness for All

Effective financial management provides the basis for the Council to achieve its priorities and objectives. This report explains a key part of effective financial management and the progress that has been made during the year.

16.2 Growth and Sustainability

Effective financial management provides the basis for the Council to achieve its priorities and objectives. This report explains a key part of effective financial management and the progress that has been made during the year.

16.3 Strong Communities

Effective financial management provides the basis for the Council to achieve its priorities and objectives. This report explains a key part of effective financial management and the progress that has been made during the year.

17. PERFORMANCE MANAGEMENT IMPLICATIONS

17.1 The report provides clear evidence of sound financial management, efficient use of resources, promotion of income generation and adherence to Best Value and good performance management.

Background Papers:
Treasury Management Strategy & Policy Report 2011/12
2011/12 CIPFA benchmarking club
Grant Thornton report - Review of the Council's arrangement for securing financial resilience

APPENDIX 1: INVESTMENTS OUTSTANDING AT 31ST MARCH 2012

Call Accounts	Amount lent (£000)	Interest rate	Maturity Date
HSBC	6,450	0.40%	On demand
Santander	6,450	0.70%	On demand
Money Market Fund			
HSBC	5,000	0.60%	On demand
Goldman Sachs	5,000	0.69%	On demand
Deutsche bank	5,000	0.77%	On demand
Ignis	5,000	0.85%	On demand
Prime Rate	5,000	0.82%	On demand
Deposits			
Salford City Council	5,700	0.50%	24th May 2012
Total	**43,600**		

APPENDIX 2: Cash Flow Position

	2011/12					Quarterly dates
	Average Balance £'m	days	Interest Earned £'k	RETURN		Balance Invested (£'m)
					31/03/2011	30.00 m
April 11	57.26 m	30	53.1 k	1.13%		
May	61.65 m	31	56.4 k	1.08%		
June	63.43 m	30	52.8 k	1.01%	30/06/2011	47.95 m
July	69.89 m	31	60.1 k	1.01%		
August	74.47 m	31	61.8 k	0.98%		
September	79.78 m	30	62.4 k	0.95%	30/09/2011	52.65 m
October	60.92 m	31	47.2 k	0.91%		
November	72.80 m	30	46.2 k	0.77%		
December	71.31 m	31	37.9 k	0.63%	31/12/2011	66.00 m
January 12	68.63 m	31	39.6 k	0.68%		
February	71.63 m	29	36.1 k	0.63%		
March	56.80 m	31	29.1 k	0.60%	31/03/2012	43.60 m
Average/Total	**67.53 m**	**366**	**582.7 k**	**0.86%**		

Appendix 3

Extract from Grant Thornton's Review of the Council's arrangement for securing financial resilience

Key Indicators

Overview of performance

Liquidity

• The Council's working capital ratio has reduced by 57% from 2007-08 to 2010-11. This has taken it from a ratio of current assets to current liabilities of 2.3:1 to 1:1.

• The majority of nearest neighbour authorities (10 out of 16) have seen a decrease over the same period. The decrease seen by the Council is over double this average at 57%, and the Council's ratio for 2010-11 is the third lowest in the benchmarked group.

• Council officers have indicated that the working capital ratio reduction is a consequence of the Council's Treasury Management strategy, which has been revised, in liaison with Arlingclose the Council's treasury management advisors, as part of the latest MTFP.

• The Council's strategy is to only borrow in advance of need if the benefits of borrowing outweigh current costs and risks associated with investing the proceeds until the borrowing was actually required. The Council's capital expenditure programme cannot be funded entirely from sources other than external borrowing.

• This planned reduction in liquidity will continue for 2012-13, but remains under review.

• HRA self-financing reforms relating to the housing subsidy system involve the removal of a one-off reallocation of debt. The settlement allocation is expected to result in the Council having to increase debt by £28.8m to fund this settlement. The Council has revised its prudential indicators for 2011-12 to reflect this increase in borrowing.

• The Council uses an internally developed Cash Flow Predictor that allows for an effective focus on cash flow management.

• The Council retains significant borrowing headroom so is in a position to borrow should greater liquidity be required. The Council's current approach to investment projects, which have to be cost neutral to proceed, should ensure that the Council's borrowing remains within appropriate parameters.

Key Indicators
Overview of performance

Borrowing

• The Council's long-term borrowing to tax revenue decreased by 55% (from 2.52 to 1.14) between 2007-08 and 2010-11. This is broadly consistent with the trend of the benchmark group of nearest neighbours.

• The Council's ratio of long-term borrowing to long-term assets has reduced by 13% from 2007-08 to 2010-11. This is follows the general trend of the nearest neighbours, with the Council's decrease (13%) below the average decrease of the benchmarked group.

• Borrowing is driven by the Council's decisions on its capital programme and the Council adopts an approach for limiting borrowing wherever possible.

• Borrowing is due to increase in 2012-13 (£46.8m compared to £24.4m in 2011-12) and is then expected to reduce to £19.2m in 2013-14 and to £12.6m in 2014-15.

• The Council's asset disposal policy supports a reduced borrowing requirement. A disposal target of £5m was established for 2011-12 with disposals realising £13m during this period, providing £8m additional capital receipts.

• As already mentioned, the Council has considerable headroom in borrowing, which could be used to support liquidity if required. Although we note that the Council's current approach to investment projects, which have to be cost neutral to proceed, should ensure that the Council's borrowing remains within appropriate parameters.