Report No.
RES12116

London Borough of Bromley

PART ONE - PUBLIC

Decision Maker:	**Executive & Resources PDS Committee and Resources Portfolio Holder Full Council**
Date:	**18th July 2012 (E&R PDS) 12th November 2012 (Council)**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**TREASURY MANAGEMENT – ANNUAL REPORT 2011/12**
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Chief Officer:	Finance Director
Ward:	All

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1. Reason for report

This report summarises treasury management activity during the March quarter and includes the Treasury Management Annual Report for 2011/12, which is required to be reported to full Council. The report also includes an update on the Council's investment with Heritable Bank (paragraph 3.11). Investments as at 31st March 2012 totalled £173.9m (excluding the balance of the Heritable investment) and there was no outstanding external borrowing.

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2. RECOMMENDATION(S)

The PDS Committee, the Portfolio Holder and full Council are asked to:

2.1 Note the Treasury Management Annual Report for 2011/12;

2.2 Approve the actual prudential indicators within the report.

Corporate Policy

1. Policy Status: Existing Policy: To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rate of return on investments.

2. BBB Priority: Excellent Council

Financial

1. Cost of proposal: Not Applicable

2. Ongoing costs: Not Applicable

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £2.691m (net) in both 2011/12 and 2012/13; surplus of £455k achieved in 2011/12 plus £730k from part-reversal of Icelandic Bank impairment

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.4 fte

2. If from existing staff resources, number of staff hours: 14 hours per week

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Legal

1. Legal Requirement: Non-Statutory - Government Guidance

2. Call-in: Applicable

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? Not Applicable

2. Summary of Ward Councillors comments:

3. COMMENTARY

General

3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year describing the activity compared to the strategy. In practice, the Finance Director has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year-end. The mid-year review for 2011/12 was considered by the PDS Committee on 14th November 2011 and was approved by the Council on 20th February. This report includes details of treasury management activity during the quarter ended 31st March 2012 and the year 1st April 2011 to 31st March 2012. The 2012/13 annual strategy, including the MRP (Minimum Revenue Provision) Policy Statement and prudential indicators, was also approved by the Council in February 2012.

3.2 Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members. The Finance Director confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Executive and Resources PDS Committee before they were reported to the full Council.

Treasury Performance in the quarter and year ended 31st March 2012

3.3 **Borrowing:** The Council's healthy cashflow position has continued into 2011/12, as a result of which no borrowing was required at all during the year. In 2009/10, only four loans were taken out to cover short-term cashflow shortages and, in 2010/11, only one small overnight loan (for £800k) was taken out (in March 2011).

3.4 **Investments:** The following table sets out details of investment activity during the March quarter and over the whole year:-

	March Qtr		**Year 2011/12**	
Main investment portfolio	**Deposits**	**Ave. Rate**	**Deposits**	**Ave. Rate**
	£m	**%**	**£m**	**%**
Core investments b/fwd	162.5	2.00	161.5	1.86
Investments made in period	66.5	1.15	162.5	1.59
Investments redeemed in period	-76.5	1.65	-171.5	1.60
Total "Core" Investments 31/03/12	152.5	2.23	152.5	2.23
Money Market Funds/Instant Access	21.4	0.86	21.4	0.86
Total Investments as at 31/03/12	**173.9**	**2.06**	**173.9**	**2.06**

3.5 Details of the outstanding investments at 31st March 2012 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. The average return on all new "core" investments during the March quarter was 1.15% which may be compared with the average 3 month LIBID rate of 0.94% and the average 7 day rate of 0.48%. The average return on new investments placed in the year 1st April to 31st March 2012 was 1.59% compared to the average 3 month rate of 0.82% and the average 7 day rate of 0.48%.

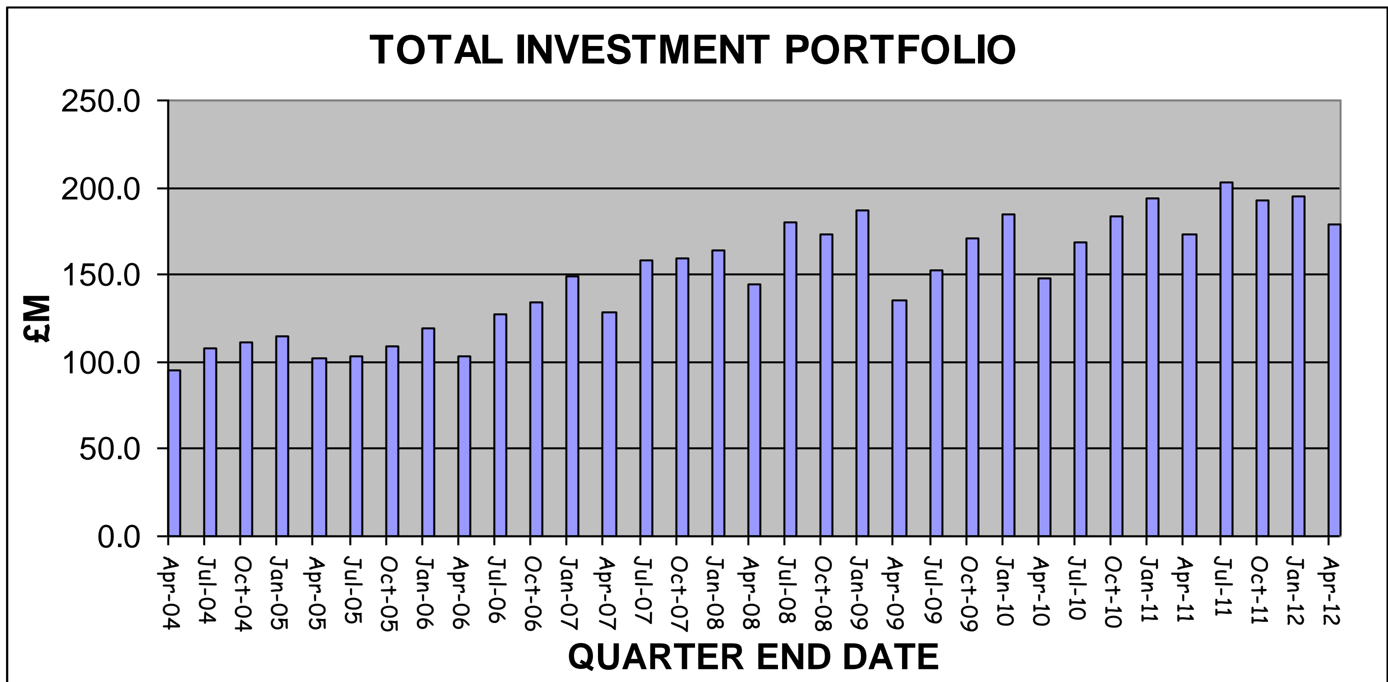
3.6 Base rate has now been 0.5% since March 2009 and the latest forecast by Sector is for it to remain at that level until late in 2013, although this forecast continues to slip and is by no means

certain. The report in January highlighted the fact that recent ratings downgrades had resulted in a number of our eligible UK bank counterparties, Barclays, Santander, Nationwide and Clydesdale, either having their limits, both monetary and time, being reduced or, in the case of Clydesdale, being removed from the list completely. As a result, our options with regard to the reinvestment of maturing deposits had become seriously limited and, as recommended by the Director of Resources, changes to the counterparty eligibility criteria were approved by the Council in February to enable us to retain some options and a degree of flexibility with regard to future investments. This helped to some extent in February and March, but we are now back in the position of not having many investment options other than placing money with instant access accounts at relatively low interest rates. Further recent downgradings to UK banks have resulted in the limits for Barclays being reduced and in the removal of Santander UK from our lending list. As a result, active banks on our list now comprise only Lloyds TSB, RBS, HSBC, Barclays and Nationwide and all but Lloyds have recently reduced their interest rates significantly. Our external advisers, Sector, continue to recommend caution and currently suggest that no investment be placed for longer than 3 months with any bank other than Lloyds and RBS (a maximum of 1 year is suggested in their case). Lloyds TSB are currently offering rates of 1.40% for 3 months up to 3.00% for 1 year, which are significantly better than the rates offered by other banks (around 0.8% currently offered by others for 3 months).

3.7 In February 2010, the Portfolio Holder agreed changes to the Council's investment strategy to allow investment for up to 2 years with the largely-government owned Lloyds TSB and Royal Bank of Scotland (since November 2008, following the Icelandic banking crash, investments had been limited to a maximum period of 1 year). The "core" investments placed in the early part of 2011/12 were in the main placed for between 6 months and a year, as was permitted by our strategy at that time. In view of continuing uncertainties in world financial markets and in line with external advice, investments were kept shorter since September, having been mainly placed for 3 or 6 months (1 year with the part-nationalised banks). In line with Sector advice, the most recent investments have been restricted to 3 months. The exceptions were Lloyds TSB, where most were placed for a year and three were placed for two years (as is permitted by our strategy and as was supported by Sector at that time) with Lloyds and RBS in order to take advantage of higher rates on offer (up to 2.80%) and the security offered by the (part-)government ownership. A proposal to the Executive on 19th October 2011 to increase the lending limit for the two part-nationalised banks from £40m to £60m was not supported. The Finance Director will continue to monitor rates and counterparty quality, as well as taking external advice, prior to any investment decisions.

3.8 The credit ratings changes since 2008 have resulted in the removal of many of our established counterparties from our lending list and, since then, it has been difficult to identify institutions to place money with. As a result, much greater use has been made of Money Market Funds, which provide a safe haven and instant access, but offer considerably lower interest rates. Information on Money Market Fund investments is provided in paragraph 3.9.

3.9 The graph below shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years, largely due to increased and earlier government funding. This has been a significant contributor to the over-achievement of investment income against budget in recent years, although this has now been fully factored into the revenue budget.



Other accounts

3.10 Money Market Funds

The Council currently has 5 Money Market Fund accounts, with Fidelity, Prime Rate, Insight, Blackrock and Ignis. In common with market rates for fixed-term investments, interest rates on money market funds have also fallen considerably in recent years, although they have recovered slightly in recent months. The Ignis fund currently offers the best rate (0.71%), which is only slightly below the 3-month rate offered by some of our eligible UK banks and building societies. The total balance held in Money Market Funds have increased in recent months as bank credit ratings downgrades have restricted counterparty eligibility.

Money Market Fund	Date Account Opened	Ave. Rate 2011/12	Ave. Daily Balance 2011/12	Actual Balance 31/03/12	Current Balance 28/06/12	Current Rate 28/06/12
		%	£m	£m	£m	%
Prime Rate	15/06/09	0.84	14.1	15.0	15.0	0.71
Ignis	25/01/10	0.82	11.4	6.4	15.0	0.73
Insight	03/07/09	0.70	2.2	-	13.0	0.69
Blackrock	16/09/09	-	-	-	-	0.54
Fidelity	20/11/02	-	-	-	-	0.52

3.11 External Cash Management

External cash managers, Tradition UK Ltd, currently manage £20m of our cash portfolio and provide useful advice and information on treasury management matters. In 2011/12, Tradition UK achieved a return of 1.70% (mainly bolstered by the two longer term investments placed in May and August (see table below)). Tradition UK, like the Council's in-house team, have been constrained by strategy changes approved after the Icelandic Bank crisis and by recent ratings downgrades. Details of externally managed funds placed on deposit as at the time of writing this report are shown below.

Sum	Start Date	Maturity	Period	Rate
Tradition UK				
£2.5m	17/05/11	27/07/12	14.5 months	2.65%
£12.5m	27/03/12	26/03/13	1 year	3 month Libor, subject to cap 1.10% & floor 0.50%
£5m	17/08/11	16/08/13	2 years	2.80%

3.12 Investment with Heritable Bank

Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki, when it was placed in administration in early-October 2008 at which time our investment was, and still is, frozen. The latest estimate given by the administrators, Ernst & Young, late in September 2011 indicates a likely return of between 86% and 90% of our claim. This represents a significant improvement on the previous estimate of between 79% and 85% and Council officers and our external advisers remain hopeful of an even better result. An initial dividend was paid to the Council in July 2009 and, since then, a further nine dividends have been received. To date, 71.7% (£3,648k) of our total claim (£5,087k) has been returned to us, leaving a balance of £1,439k (28.3%).

For information, the claim we were obliged to submit consisted of the principal sum (£5m) plus interest due to the date on which Heritable was placed in administration (around £87,000). We were not able to lodge a claim for the full amount of interest (£321,000) that would have been due at the original investment maturity date (29/6/09). In accordance with proper accounting practice and guidance from CIPFA, we made provision in our 2008/09 accounts for an impairment loss of £1.64m and met this from the General Fund in the year. In line with revised guidance from CIPFA relating to the 2009/10 accounts, we were able to reduce the impairment by £300k and this sum was credited to the General Fund. The latest improved recovery estimate of between 86% and 90% enabled us to reverse a further £730k of the impairment in 2011/12. This left a provision for a net loss of £610k in the accounts as at 31st March 2012, which will potentially reduce or clear depending on the size of the final settlement sum.

Actual prudential indicators for 2011/12

3.13 The old capital control system was replaced in April 2004 by a prudential system based largely on self-regulation by local authorities themselves. At the heart of the system is The Prudential Code for Capital Finance in Local Authorities, developed by CIPFA. The Code requires the Council to set a number of prudential indicators designed to monitor and control capital expenditure, financing and borrowing. The indicators for 2011/12 were approved by the Executive and the Council in February 2011 and Appendix 3 sets out the actual performance against those indicators.

Economic Background for 2011/12 (provided by Sector)

Sovereign debt crisis**.**

3.14 2011/12 was the year when financial markets were on tenterhooks throughout most of this period, fearful of the potential of another Lehmans type financial disaster occurring, sparked off by a precipitous Greek default. At almost the last hour, the European Central Bank (ECB) calmed market concerns of a liquidity crisis among European Union (EU) banks by making available two huge three year credit lines, totalling close to €1 trillion at 1%. This also provided a major incentive for those same banks to then use this new liquidity to buy EU sovereign debt yielding considerably more than 1%.

3.15 A secondary benefit of this initiative was the bringing down of sovereign debt yields, for the likes of Italy and Spain, below panic levels. The final planks in the calming of the EU sovereign debt crisis were two eleventh hour agreements: one by the Greek Government of another major austerity package and the second, by private creditors, of a "haircut" (discount) on the value of Greek debt that they held, resulting in a major reduction in the total outstanding level of Greek debt. These agreements were a prerequisite for a second EU / IMF bailout package for Greece which was signed off in March.

3.16 Despite this second bailout, major concerns remain that these measures were merely a postponement of the debt crisis, rather than a solution, as they did not address the problem of low growth and loss of competitiveness in not only Greece, but also in other EU countries with major debt imbalances. These problems will, in turn, also affect the financial strength of many already weakened EU banks during the expected economic downturn in the EU. There are also major questions as to whether the Greek Government will be able to deliver on its promises of cuts in expenditure and increasing tax collection rates, given the hostility of much of the population. In addition, an impending general election in April / May 2012 will deliver a democratic verdict on the way that Greece is being governed under intense austerity pressure from the northern EU states.

3.17 The UK coalition Government maintained its aggressive fiscal policy stance against a background of warnings from two credit rating agencies that the UK could lose its AAA rating. Key to retaining this rating will be a return to strong economic growth in order to reduce the national debt burden to a sustainable level, within the austerity plan timeframe. The USA and France lost their AAA ratings from one rating agency during the year.

3.18 UK growth proved mixed over the year. In quarter 2, growth was zero, but then quarter 3 surprised with a return to robust growth of 0.6% q/q before moving back into negative territory (-0.2%) in quarter 4. The year finished with prospects for the UK economy being decidedly downbeat due to a return to negative growth in the EU in quarter 4, our largest trading partner, and a sharp increase in world oil prices caused by Middle East concerns. However, there was also a return of some economic optimism for growth outside the EU and dovish comments from the major western central banks: the Fed in America may even be considering a third dose of quantitative easing to boost growth.

3.19 UK CPI inflation started the year at 4.5% and peaked at 5.2% in September. The fall out of the January 2011 VAT hike from the annual CPI figure in January 2012 helped to bring inflation down to 3.6%, falling further to 3.4% in February. Inflation is forecast to be on a downward trend to below 2% over the next year.

3.20 The Monetary Policy Committee agreed an increase in quantitative easing (QE) of £75bn in October on concerns of a downturn in growth and a forecast for inflation to fall below the 2% target. QE was targeted at further gilt purchases. The MPC then agreed another round of £50bn of QE in February 2012 to counter the negative impact of the EU debt and growth crisis on the UK.

3.21 Gilt yields fell for much of the year, until February, as concerns continued building over the EU debt crisis. This resulted in safe haven flows into UK gilts which, together with the two UK packages of QE during the year, combined to depress PWLB rates to historically low levels.

3.22 Bank Rate was unchanged at 0.5% throughout the year while expectations of when the first increase would occur were steadily pushed back until the second half of 2013 at the earliest. Deposit rates picked up in the second half of the year as competition for cash increased among banks.

3.23 Risk premiums were also a constant factor in raising money market deposit rates for periods longer than 1 month. Widespread and multiple downgrades of the ratings of many banks and sovereigns, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, meant that investors remained cautious of longer-term commitment.

Regulatory Framework, Risk and Performance

3.24 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.25 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to seek to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk, particularly security and liquidity.

5. FINANCIAL IMPLICATIONS

5.1 These are contained in the body of the report. An average rate of interest of 1.67% was achieved in 2011/12, including 1.59% on all new "core" investments placed during the year (compared to the budget assumption of 1.5%). The final outturn for net interest on investments and borrowing in 2011/12 was £3,876kk, almost £1.2m above the budget of £2,691k. The surplus included £730k for the part-reversal of the Heritable impairment and additional interest earnings of £455k compared to the forecast of £300k. On 20th June, the Executive agreed that the total surplus of £1,185k be transferred into a new earmarked reserve, The Interest Rate Risk Reserve, with the intention of mitigating potential future interest losses.

5.2 With regard to 2012/13, an average rate of 1.5% has been assumed for interest on new investments in the 2012/13 revenue budget, in line with the estimates provided by the Council's external treasury advisers, Sector, earlier in the year and with officers' views. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £200k in 2012/13 and £400k per annum thereafter.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Sector Treasury Services

APPENDIX 3

Prudential and Treasury Indicators – Actual 2011/12

Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy. The table below shows the actual performance in relation to the indicators in 2010/11 and compares the actual in 2011/12 with the original estimates approved in February 2011 and the revised estimates ("probable") reported when the indicators for 2012/13 were approved in February 2012. Further details on capital expenditure outturn were reported to the Executive on 20th June 2012.

The Council is required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the full Council in February 2002 and the revised Code was adopted by full Council in February 2010.

PRUDENTIAL INDICATORS	2010/11	2011/12	2011/12	2011/12
	actual	estimate	probable	actual
	£m	£m	£m	£m
Total Capital Expenditure	£49.4m	£52.5m	£54.6m	£48.8m
Ratio of financing costs to net revenue stream	-2.6%	-1.3%	-1.3%	-1.3%
Net borrowing requirement (net investments for Bromley)				
brought forward 1 April	£133.9m	£134.5m	£163.1m	£163.1m
carried forward 31 March	£163.1m	£124.3m	£143.0m	£170.3m
in year borrowing requirement (reduction in net investments for Bromley)	+29.2m	-£10.2m	-£20.1m	+£7.2m
Capital Financing Requirement as at 31 March (unfinanced exp re SEN provision & finance lease liability)	£7.5m	£4.4m	£7.2m	£3.6m
Annual change in Cap. Financing Requirement	-£0.3m	-£3.1m	-£0.3m	-£3.9m
Incremental impact of capital investment decisions	£ p	£ p	£ p	£ p
Increase in council tax (band D) per annum	-	-	-	-

TREASURY MANAGEMENT INDICATORS	2010/11	2011/12	2011/12	2011/12
	actual	estimate	probable	actual
	£m	£m	£m	£m
Authorised Limit for external debt -				
borrowing	£30.0	£30.0	£30.0	£30.0m
other long term liabilities	£30.0	£30.0	£30.0	£30.0m
TOTAL	£60.0	£60.0	£60.0	£60.0m
Operational Boundary for external debt -				
borrowing	£10.0	£10.0	£10.0	£10.0m
other long term liabilities	£20.0	£20.0	£20.0	£20.0m
TOTAL	£30.0	£30.0	£30.0	£30.0m
Actual external debt	£7.5	£10.0	£7.2	£3.6m
Upper limit for fixed interest rate exposure	100%	100%	100%	100%
Upper limit for variable rate exposure	20%	20%	20%	20%
Upper limit for total principal sums invested beyond year-end dates	£37.5	£134.3	£80.0	£173.9m