Annual Treasury Report 2010/11 for Epping Forest District Council

1. Background

The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ("the Code"), which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. The Council reports twice a year to the Finance & Performance Management Cabinet Committee and scrutiny of treasury policy, strategy and activity is delegated to the Audit & Governance Committee.

Treasury management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.

2. Economic Background

At the time of determining the strategy for 2010/11, interest rates were expected to remain low in response to the fragile state of the UK economy. Spending cuts and tax increases seemed inevitable post the General Election if the government had a clear majority. The markets had, at the time, viewed a hung parliament as potentially disruptive particularly if combined with a failure to articulate a credible plan to bring down government borrowing. The outlook for growth was uncertain due to consumers and corporates trimming their spending and financial institutions exercising restraint in new lending.

The economy's two headline indicators moved in opposite directions – growth was lacklustre whilst inflation spiked sharply higher. The economy grew by just 1.3% in calendar year 2010; the forecast for 2011 was revised down to 1.7% by the Office of Budget Responsibility in March. Higher commodity, energy and food prices and the increase in VAT to 20% pushed the February 2011 annual inflation figure to 4.4%. The Bank Rate was held at 0.5% as the economy grappled with uneven growth and the austerity measures set out in the coalition government's Comprehensive Spending Review. Significant cuts were made to public expenditure, in particular local government funding.

The US Federal Reserve (the Fed) kept rates on hold at 0.25% following a slowdown in American growth. The European Central Bank maintained rates at 1%, with the markets expecting a rate rise in early Spring.

The credit crisis migrated from banks to European sovereigns. The ratings of Ireland and Portugal were downgraded to the 'triple-B' category whilst the rating of Greece was downgraded to sub-investment (or 'junk') grade. The sovereign rating of Spain was also downgraded but remained in the 'double-A' category. The results from the EU Bank Stress Tests, co-ordinated by the Committee of European Banking Supervisors, highlighted that only 7 out of the 91 institutions failed the 'adverse scenario' tests. The tests were a helpful step forward, but there were doubts if they were far-reaching or demanding enough. The main UK banks' (Barclays, HSBC, Lloyds and RBS) Tier 1 ratios all remained above 9% under both the 'benchmark scenario' and the 'adverse scenario' stress tests. The tests will be repeated in the Spring of 2011.

Gilts benefitted from the decisive Comprehensive Spending Review (CSR) plans as well as from their relative 'safe haven' status in the face of European sovereign weakness. 5-year and 10-year gilt yields fells to lows of 1.44% and 2.83% respectively. However yields rose in the final quarter across all gilt maturities on concern that higher inflation would become embedded and greatly diminish the real rate of return for fixed income investors.

During the year money market rates increased marginally at the shorter end (overnight to 3 months). 6 - 12 month rates increased between 0.25% to 0.30% over the 12 month period reflecting the expectation that the Bank Rate would be raised later in 2011.

3. The Borrowing Requirement and Debt Management

The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31/3/2011 was estimated at negative £0.784m . The Council's borrowing requirement during the year was nil.

The Council funded all of its capital expenditure through internal resources.

4. Investment Activity

The CLG's revised Investment Guidance came into effect on 1st April 2010 and reiterated the need to focus on security and liquidity, rather than yield. It also recommended that strategies include details of assessing credit risk, reasons for borrowing in advance of need and the use of treasury advisers.

Investments	Balance on 31/3/2010 £m	Investments Made £m	Maturities/ Investments Sold £m	Balance on 31/03/2011 £m	Avg Rate % / Avg Life (days)
Short Term Investments	39.483	107,000.0	98.963	47.520	Rate = 1.33% Life = 88 days
Long Term Investments	0.673	0.0	0.357	0.316	NA
TOTAL INVESTMENTS	**40.156**	**107,000.0**	**99.320**	**47.836**	

The movement in total investments from £40.156m to £47.836m (£7.68m) is the result of the movement our net current assets / liabilities from the Council being owed £6.021m in net debtors at the end of March 2010 to the Council owing creditors £2.113m in net creditors at the end of March 2011. This was largely due to changes in balances owed to / by the Government in respect of benefit payments and non-domestic rate receipts.

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2010/11. Investments during the year included:

- Investments in AAA-rated Stable Net Asset Value Money Market Funds
- Call accounts and deposits with Banks and Building Societies systemically important to that country's banking system (UK and France).

Credit Risk: Counterparty credit quality was assessed and monitored with reference to credit ratings (Council's minimum long-term counterparty rating of A+ across all three rating agencies, Fitch, S&P and Moody's); credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP; any potential support mechanisms and share price. Counterparty credit quality has progressively strengthened as demonstrated by the Credit Score Analysis summarised below. The table in Appendix 2 explains the credit score and that the Council has a target score of 5 or lower.

Date	Value Weighted Average Credit Risk Score	Value Weighted Average Credit Rating	Time Weighted Average Credit Risk Score	Time Weighted Average Credit Rating	Average Life (days)
31/03/2010	*4.30*	*AA-*	*4.40*	*AA-*	*182*
30/06/2010	*4.23*	*AA-*	*4.37*	*AA-*	*93*
30/09/2010	*3.71*	*AA-*	*3.89*	*AA-*	*82*
31/12/2010	*3.72*	*AA-*	*3.93*	*AA-*	*91*
31/03/2011	*3.83*	*AA-*	*3.93*	*AA-*	*96*

Liquidity: In keeping with the CLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds / overnight deposits/ the use of call accounts.

Yield: The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year. Short term money market rates remained at very low levels (as shown in table 1 in Appendix 2) which had a significant impact on investment income.

The Council's budgeted investment income for the year had been estimated at £0.897m. The average cash balances representing the Council's reserves, were £51.6m during the period and interest earned was £0.653m.

Update on Investments with Icelandic banks
Following guidance from CIPFA, issued in September 2010, and further developments within the financial year, the following is now known:

- ***Heritable*** – It is now expected that 86p-90p/£ (was 79p-85p/£ as at 31 March 2011) will be recovered overall. Repayments in 2010/11 were 6.27% in July, 4.14% in October and 4.72% in January. In total, 50.1% has been repaid to 31 March 2011. The Council have since received two further dividends during 2011/12 for 6.2% in April and 4.1% in July.

5. Compliance with Prudential Indicators

The Council can confirm that it has complied with its Prudential Indicators for 2010/11, which were set in February 2010 as part of the Council's Treasury Management Strategy Statement. Details can be found in Appendix 1.

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during 2010/11. None of the Prudential Indicators has been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

6. Reform of Council Housing Finance

In its publication ***Implementing self-financing for council housing*** issued in February 2011 the CLG set out the rationale, methodology and financial parameters for the initiative.

Subject to the Localism Bill receiving Royal Assent and a commencement order being passed, the proposed transfer date is Wednesday 28th March 2012 (this fits with PWLB timetables on the payment/receipt of funds to clear by 31st March 2012.)

The self-financing model provides an indicative sustainable level of opening housing debt. As the Council's debt level generated by the model is higher than the Subsidy Capital Financing Requirement (SCFR), the Council will be required to pay the CLG the difference between the two, which is approximately £181m. This will require the Council to fund this amount in the medium term through internal resources and/or external borrowing. The Council has the option of borrowing from the PWLB or the market.

The treasury management implications of HRA reform and an appropriate strategy to manage the process are being actively reviewed with the Council's Treasury Advisor including the issues surrounding any early prefunding of the significant settlement payment (primarily the powers to borrow and the cost of carry).

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Appendix 1

Capital Financing Requirement
Estimates of the Council's cumulative maximum external borrowing requirement for 2010/11 to 2012/13 are shown in the table below:

	31/3/2011 Estimate £000s	31/3/2011 Actual £000s	31/3/2012 Estimate £000s	31/3/2013 Estimate £000s
Non-HRA CFR	22,019	38,542	38,542	38,542
HRA CFR	-22,803	-39,326	141,674	141,674
Capital Financing Requirement	**-784**	**-784**	**180,216**	**180,216**
Less: Existing Profile of Borrowing	0	0	0	0
Less: Other Long Term Liabilities	0	0	0	0
Cumulative Maximum External Borrowing Requirement	**-784**	**-784**	**180,216**	**180,216**

Balances and Reserves
Estimates of the Council's level of Balances and Reserves for 2010/11 to 2012/13 are as follows:

	31/3/2011 Estimate £000s	31/3/2011 Actual £000s	31/3/2012 Estimate £000s	31/3/2013 Estimate £000s
Balances and Reserves	50,000	51,649	47,000	43,000

Prudential Indicator Compliance

(a) Authorised Limit and Operational Boundary for External Debt

- The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit which should not be breached.
- The Council's Affordable Borrowing Limit was set at £5m for 2010/11.
- The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.
- The Operational Boundary for 2010/11 was set at £0.5m.
- The Director of Finance & ICT confirms that there were no breaches to the Authorised Limit and the Operational Boundary during the year; No borrowing was undertaken during 2010/11.

(b) Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

- These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.
- The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2010/11 %	Maximum during 2010/11 %
Upper Limit for Fixed Rate Exposure	100	84.26
Compliance with Limits:	Yes	Yes
Upper Limit for Variable Rate Exposure	50	37.29
Compliance with Limits:	Yes	Yes

(c) Maturity Structure of Fixed Rate Borrowing

- This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates.

Maturity Structure of Fixed Rate Borrowing	Upper Limit %	Lower Limit %	Actual Fixed Rate Borrowing as at 31/03/2011	% Fixed Rate Borrowing as at 31/03/2011	Compliance with Set Limits?
under 12 months	100	0	0	0	Yes
12 months and within 24 months	0	0	0	0	Yes
24 months and within 5 years	0	0	0	0	Yes
5 years and above	0	0	0	0	Yes

(d) **Total principal sums invested for periods longer than 364 days**

- This indicator allows the Council to manage the risk inherent in investments longer than 364 days.
- The limit for 2010/11 was set at £30m.
- The Council's policy response since the onset of the credit crunch in 2007 was to keep investment maturities within the boundaries set by our treasury advisors. During the year we invested £5m for a period greater than 364 days.

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Appendix 2

The average, low and high rates correspond to the rates during the financial year rather than those in the tables below

Table 1: Bank Rate, Money Market Rates

Date		Bank Rate		O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/04/2010		0.50		0.35	0.35	0.42	0.51	0.81	1.26	1.54	2.07	2.82
30/04/2010		0.50		0.30	0.30	0.43	0.53	0.83	1.29	1.70	2.23	2.95
31/05/2010		0.50		0.45	0.50	0.61	0.60	0.85	1.35	1.46	1.89	2.58
30/06/2010		0.50		0.35	0.35	0.45	0.61	0.94	1.38	1.40	1.79	2.42
31/07/2010		0.50		0.40	0.40	0.50	0.71	1.01	1.46	1.36	1.75	2.39
31/08/2010		0.50		0.40	0.55	0.50	0.71	1.00	1.45	1.20	1.47	2.02
30/09/2010		0.50		0.30	0.25	0.51	0.72	1.01	1.46	1.24	1.51	2.05
31/10/2010		0.50		0.48	0.40	0.51	0.72	1.01	1.46	1.26	1.53	2.08
30/11/2010		0.50		0.40	0.51	0.51	0.72	0.88	1.46	1.32	1.66	2.30
31/12/2010		0.50		0.40	0.40	0.51	0.72	1.01	1.47	1.49	1.94	2.61
31/01/2011		0.50		0.40	0.55	0.52	0.64	1.04	1.52	1.74	2.21	2.90
28/02/2011		0.50		0.40	0.54	0.53	0.68	1.09	1.56	1.85	2.29	2.95
31/03/2011		0.50		0.30	0.50	0.54	0.80	1.11	1.58	1.85	2.31	2.96
Minimum		0.50		0.30	0.25	0.42	0.51	0.75	1.00	1.13	1.37	1.92
Average		**0.50**		**0.39**	**0.43**	**0.50**	**0.67**	**0.98**	**1.44**	**1.50**	**1.90**	**2.54**
Maximum		0.50		0.55	0.55	0.80	0.80	1.11	1.58	1.97	2.49	3.19
Spread				0.25	0.30	0.38	0.29	0.36	0.58	0.84	1.12	1.26

Table 2 : PWLB Borrowing Rates – Fixed Rate, Maturity Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2010	064/10	0.81	2.84	4.14	4.21	4.60	4.61	4.63
30/04/2010	089/10	0.85	2.86	4.13	4.20	4.61	4.61	4.60
28/05/2010	127/10	0.73	2.46	3.76	3.83	4.36	4.38	4.38
30/06/2010	171/10	0.67	2.27	3.54	3.62	4.22	4.28	4.27
30/07/2010	217/10	0.70	2.29	3.55	3.62	4.32	4.41	4.40
31/08/2010	259/10	0.63	1.84	3.05	3.13	3.82	3.93	3.93
30/09/2010	303/10	0.64	1.88	3.14	3.86	4.00	4.03	4.02
29/10/2010	346/10	1.58	2.90	4.23	5.06	5.2	5.22	5.2
30/11/2010	390/10	1.56	3.05	4.40	5.18	5.26	5.25	5.23
31/12/2010	430/10	1.65	3.33	4.58	5.18	5.23	5.20	5.16
31/01/2011	040/11	1.79	3.57	4.80	5.40	5.46	5.44	5.40
28/02/2011	080/11	1.87	3.61	4.75	5.33	5.38	5.35	5.31
31/03/2011	126/11	1.89	3.57	4.71	5.27	5.30	5.27	5.24
	Low	0.60	1.81	3.05	3.82	3.93	3.93	3.92
	Average	1.19	2.79	4.05	4.72	4.79	4.78	4.76
	High	1.99	3.84	5.00	5.50	5.55	5.53	5.48

Table 3: PWLB Borrowing Rates – Fixed Rate, EIP Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2010	064/10	--	1.78	2.94	4.18	4.53	4.60	4.62
30/04/2010	089/10	--	1.82	2.96	4.16	4.53	4.61	4.62
28/05/2010	127/10	--	1.52	2.55	3.79	4.24	4.36	4.39
30/06/2010	171/10	--	1.38	2.36	3.58	4.06	4.23	4.27
30/07/2010	217/10	--	1.42	2.38	3.58	4.11	4.33	4.40
31/08/2010	259/10	--	1.12	1.92	3.09	3.61	3.82	3.91
30/09/2010	303/10	--	1.14	1.96	3.18	3.67	3.87	3.96
29/10/2010	346/10	--	2.11	2.98	4.27	4.84	5.07	5.16
30/11/2010	390/10	--	2.19	3.14	4.44	4.99	5.19	5.25
31/12/2010	430/10	--	2.43	3.42	4.62	5.05	5.19	5.23
31/01/2011	040/11	--	2.62	3.66	4.84	5.25	5.40	5.45
28/02/2011	080/11	--	2.71	3.69	4.79	5.18	5.33	5.38
31/03/2011	126/11	--	2.69	3.65	4.74	5.14	5.28	5.31
	Low		1.10	1.89	3.09	3.61	3.82	3.91
	Average		1.91	2.87	4.08	4.55	4.72	4.77
	High		2.88	3.93	5.03	5.38	5.51	5.55

Table 4: PWLB Variable Rates

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR	Pre-CSR	Pre-CSR	Post-CSR	Post-CSR	Post-CSR
01/04/2010	0.65	0.65	0.70			
30/06/2010	0.65	0.70	0.70			
30/09/2010	0.65	0.70	0.70			
31/12/2010	0.70	0.70	0.75	1.60	1.60	1.65
31/03/2011	0.67	0.76	0.88	1.57	1.66	1.78
Low	0.65	0.65	0.68	1.55	1.56	1.58
Average	0.66	0.68	0.73	1.57	1.61	1.68
High	0.70	0.79	0.90	1.60	1.69	1.80

Table 5: Credit Score Analysis

Scoring:

Long-Term Credit Rating	Score
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10
Not rated	11
BB	12
CCC	13
C	14
D	15

The value weighted average reflects the credit quality of investments according to the size of the deposit. The time weighted average reflects the credit quality of investments according to the maturity of the deposit

The Council aims to achieve a score of 5 or lower, to reflect the Council's overriding priority of security of monies invested and the minimum credit rating of threshold of A+ for investment counterparties.