ROTHERHAM BOROUGH COUNCIL – REPORT TO MEMBERS

1.	**Meeting:**	**Audit Committee**
2.	**Date:**	**28th September 2011**
3.	**Title:**	**Annual Treasury Management Report and Actual Prudential Indicators 2010/11**
4.	**Directorate:**	**Financial Services**

5. Summary

The annual treasury management report is a requirement of the Council's reporting procedures and covers the treasury activity for 2010/11. The report also covers the actual Prudential Indicators for 2010/11 in accordance with the requirements of the Prudential Code.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. During 2010/11 the Council received an annual treasury strategy in advance of the year and an annual report following the year describing the activity compared to the strategy (this report). In addition the Council also received a mid year treasury report following regulatory changes. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

6. Recommendation

Audit Committee is asked to approve the Annual Treasury Management Report.

7. Proposals and Details

The Strategic Director of Finance has delegated authority to carry out treasury management activities on behalf of the Council and this report is produced in order to comply with the CIPFA Code of Practice in respect of Treasury Management in Local Authorities and the “Prudential Code”.

8. Finance

Treasury Management forms an integral part of the Council’s overall financial arrangements.

9. Risks and Uncertainties

Regular monitoring will ensure that risks and uncertainties are addressed at an early stage and hence kept to a minimum.

10. Policy and Performance Agenda Implications

Effective treasury management will assist in delivering the Council’s policy and performance agenda.

11. Background Papers and Consultation

CIPFA – Code of Practice for Treasury Management in the Public Services
Local Government Act 2003
CIPFA – Prudential Code

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Annual Report on the Treasury Management Service and Actual Prudential Indicators 2010/11

Executive Summary

During 2010/11 the Council complied with its legislative and regulatory requirements in terms of setting, monitoring and reporting on its prudential indicators for the year.

Indicators are set prior to the start of the financial year and reflect the known position at that time. Approved changes to the capital programme and its funding throughout the financial year, together with variations in treasury management activity, does mean that actual indicators for the year may vary from the initial projections made prior to the start of the financial year. However by regularly monitoring these indicators the Council is able to ensure the impact is known and managed through the Medium Term Financial Strategy.

The actual prudential indicators for 2010/11, with comparators, are as follows:

	2010/11 Actual £m	**2010/11 Revised Indicator £m**	**2010/11 Original Indicator £m**	**Restated 2009/10 Actual £m**
Capital Expenditure	99.635	109.141	110.651	151.357
Capital Financing Requirement: Non-HRA	294.410	297.528	294.709	276.946
HRA	284.865	288.544	286.346	273.459
Total excluding PFI and similar arrangements	579.276	586.072	581.499	550.405
Cumulative adjustment for PFI and similar arrangements	115.379	114.146	-	117.471
Total including PFI schemes and similar arrangements	694.655	700.218	-	667.876
	%	%	%	%
Financing Costs as a proportion of Net Revenue Stream: Non-HRA	8.61	9.10	10.40	8.35
HRA	14.20	15.07	15.28	14.86

The main reasons for the change in the actual indicators, from those originally set in March 2010 are as follows:

- Due to re-profiling actual capital expenditure in the year was less than anticipated. This change which led to a change in borrowing need gave rise to a reduction in the Capital Financing Requirement at the end of the year when compared to the estimated position.

- The impact of the reduced borrowing need and on-going prudent treasury management activity gave rise to corresponding reductions in the other indicators when compared to the estimated position.

The Strategic Director of Finance also confirms that borrowing was only undertaken for a capital purpose and the Statutory Borrowing Limit, the Authorised Limit, was not breached.

At 31 March 2011, the Council's external debt totalled £437.136m (£412.636m at 31 March 2010) and its investments totalled £2.846m (£15.979m at 31 March 2010).

At 31 March 2010, the Former South Yorkshire County Council external debt totalled £96.412m (£102.012m at 31 March 2010). The Former SYCC had no investments at that date (nil at 31 March 2010).

1. Introduction

1.1 This report summarises:

- the capital activity for the year;
- how this activity was financed;
- the impact on the Council's indebtedness for capital purposes;
- the Council's overall treasury position;
- the reporting of the required prudential indicators;
- debt activity; and
- investment activity.

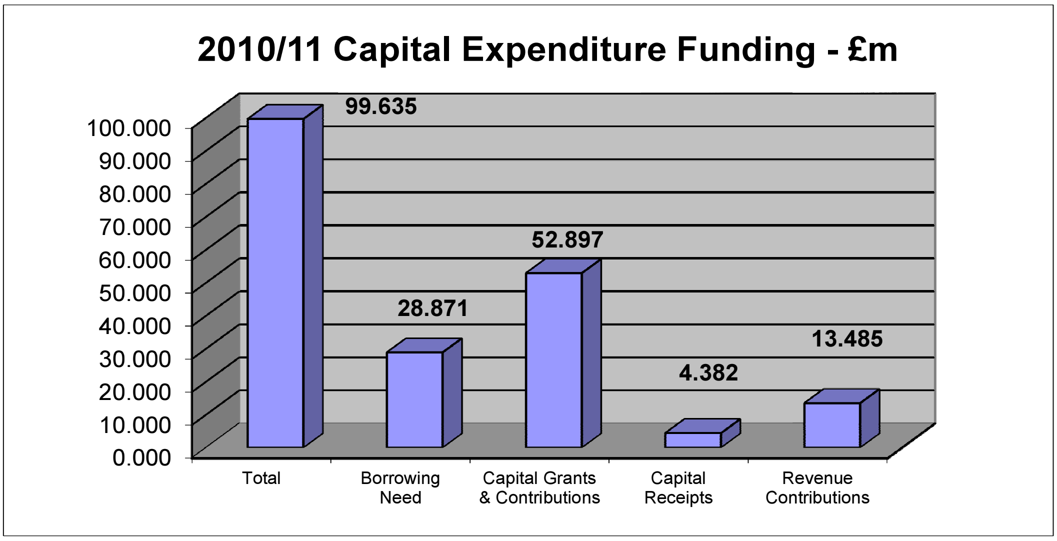
2. The Council's Capital Expenditure and Financing 2010/11

2.1 The Council undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately through capital receipts, capital grants etc.; or
- If insufficient financing is available the expenditure will give rise to a borrowing need.

2.2 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then optimise performance. The primary objective is security ahead of liquidity and then yield or return. Wider information on the regulatory requirements is shown in Section 8.

2.3 The actual capital expenditure forms one of the required prudential indicators. The graph below also shows how this was financed.



3. The Council's Overall Borrowing Need

3.1 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position. It represents 2010/11 and prior years net capital expenditure which has not yet been paid for by revenue or other resources.

3.2 The Non-HRA element of the CFR is reduced each year by a statutory revenue charge (called the Minimum Revenue Provision - MRP). The total CFR can also be reduced by:

- the application of additional capital resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

CLG Regulations require Full Council to approve an MRP Statement in advance of each year. Detailed rules have been replaced by a single duty to charge an amount of MRP which the Council considers 'prudent'. The Council approved the following revised MRP policy in relation to the charges for the 2010/11 as part of the Treasury Management Strategy for 2011/12 on 2 March 2011:

(a) The MRP charge in relation to borrowing for capital expenditure incurred prior to 2007/08 will be unaffected by the regulations;

(b) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by both supported and unsupported borrowing will be calculated using the expected useful life of the asset at the point the asset is brought into use; and

(c) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by a 'capitalisation directive' (e.g. equal pay) will be calculated on the basis of equal instalments over the specified period(s) set down within the regulations.

3.3 The Council's CFR for the year is shown below, and represents a key prudential indicator. A key accounting change in 2009/10 was the inclusion of the Council's PFI schemes and similar arrangements on the Council's balance sheet. This has the effect of increasing the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is already included in the contract. The adjustments required were finalised during the 2009/10 accounts closedown and therefore were not reflected in the original indicator for 2010/11.

CFR (£m)	31 March 2011 Actual £m	31 March 2011 Revised Indicator £m	31 March 2011 Original Indicator £m	Restated 31 March 2010 Actual £m
Opening balance (excluding on-balance sheet PFI and similar arrangements)	550.405	549.472	549.194	475.478
Plus increase in borrowing need	38.327	48.004	43.556	83.333
Less MRP/VRP/Met Debt Principal Repayment	-9.456	-11.129	-11.251	-8.406
Closing balance (excluding on-balance sheet PFI and similar arrangements)	579.276	586.347	581.499	550.405
Closing balance (excluding on-balance sheet PFI and similar arrangements)	**579.276**	**586.347**	**-**	**550.405**
Plus cumulative PFI adjustments	115.379	114.146	-	117,471
Closing balance (including on-balance sheet PFI and similar arrangements)	**694.655**	**700.493**	**-**	**667.876**

3.4 Actual capital expenditure in 2010/11 which was funded by borrowing was less than had been estimated. As a result the Council's closing CFR was lower than that approved as the revised indicator for the year.

4. Treasury Position at 31 March 2011

4.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Strategic Director of Finance and the treasury function can manage the Council's actual borrowing position by either:

- borrowing to the CFR (excluding the impact of PFI and similar contracts); or
- choosing to utilise some temporary internal cash flow funds instead of borrowing (under-borrowing); or
- borrowing for future increases in the CFR (borrowing in advance of need).

4.2 It should be noted that accounting practice defined by the Code of Practice requires financial instruments in the accounts (debt and investments etc.) to be measured in a method compliant with International Financial Reporting Standards. The figures in this report are based on the amounts borrowed and invested and so may differ from those shown in the final accounts by items such as accrued interest.

4.3 The expectation for 2010/11 had been that borrowing would have been mainly in line with the estimated borrowing need for the year whilst partly reducing the Council's 31 March 2010 under-borrowed position. The continued volatility in the financial markets was such that the most prudent approach was to continue to utilise temporary cash flow funds instead of borrowing. The Council's treasury position at the 31 March 2011 compared with the previous year was:

RMBC Treasury position	**31 March 2011**		**31 March 2010**	
	Principal £m	**Average Rate %**	**Principal £m**	**Average Rate %**
Fixed Interest Rate Debt *	326.636	5.07	316.636	5.23
Variable Interest Rate Debt **	111.000	4.13	96.000	3.94
Total Debt	437.636	4.83	412.636	4.93
Fixed Interest Investments	2.846	*** 0.00	15.979	4.05
Variable Interest Investments	0	0.00	0	0.00
Total Investments	2.846	0.00	15.979	4.05
Net borrowing position	**434.790**		**396.657**	

* Includes all debt where the interest rate is fixed for the whole of the following financial year
** Includes all debt where the interest rate may be subject to interest rate variation on specified dates during the following financial year
*** The investments shown represent the principal outstanding on the Council's Icelandic investments hence the average rate is shown as zero

4.4 Against the Council's Capital Financing Requirement (£579.275m), the Council's outstanding debt levels (£437.636m) are lower than this Requirement by approximately £142m due to the Council's prudent and sensible approach to utilise temporary cash flow funds rather than take out additional borrowings. A Council is generally allowed to borrow up to its CFR.

4.5 The Council's net borrowing position reflects the capital spend that is yet to be financed from revenue or other resources as it is to be repaid over a prudent and affordable period in line with the Council's Minimum Revenue Provision Policy.

4.6 The former SYCC's treasury position at the 31 March 2011 compared with the previous year was:

Former SYCC Treasury position	31 March 2011		31 March 2010	
	Principal £m	Average Rate %	Principal £m	Average Rate %
Fixed Interest Rate Debt *	96.412	5.92	102.012	5.83
Variable Interest Rate Debt **	0	0.00	0	0.00
Total Debt	96.412	5.92	102.012	5.83
Fixed Interest Investments	0	0.00	0	0.00
Variable Interest Investments	0	0.00	0	0.00
Total Investments	0	0.00	0	0.00
Net borrowing position	**96.412**		**102.012**	
* Includes all debt where the interest rate is fixed for the whole of the following financial year ** Includes all debt where the interest rate may be subject to interest rate variation on specified dates during the following financial year				

5. Prudential Indicators and Compliance Issues

5.1 Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

5.2 **Net Borrowing and the CFR** - In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, exceed the CFR for 2010/11 plus the expected changes to the CFR over 2011/12 and 2012/13. The table below highlights the Council's net borrowing position against the CFR and demonstrates that the Council has complied with this prudential indicator, i.e., the Council's net borrowings are lower than its CFR.

RMBC Treasury Position	31 March 2011 Actual £m	31 March 2011 Revised Indicator £m	31 March 2011 Original Indicator £m	Restated 31 March 2010 Actual £m
Net borrowing position	434.790	456.069	451.499	396.657
CFR (excluding PFI and similar arrangements)	579.275	586.347	581.499	550.405

5.3 **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by S3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2010/11 the Council has maintained gross borrowing within its Authorised Limit, both excluding and including the impact of bringing PFI and similar arrangements on to the Council's Balance Sheet.

Authorised Limit	RMBC £m	Former SYCC £m	Total £m
Original Indicator – Authorised Limit	624.303	102.012	726.315
Revised Indicator – Authorised Limit	604.615	102.012	706.627
Actual indicator – Maximum gross borrowing position – External Debt only	442.636	102.012	544.648
Actual indicator - Maximum gross borrowing position – External Debt plus PFI and similar arrangements	560.107	102.012	662.119

5.4 **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached. The table below demonstrates that during 2010/11 the Council has maintained its borrowing position within its Operational Boundary, both excluding and including the impact of bringing PFI and similar arrangements on to the Council's Balance Sheet.

Operational Boundary for External Debt	RMBC £m	Former SYCC £m	Total £m
Original Indicator - Operational Boundary	579.487	102.012	681.499
Revised Indicator - Operational Boundary	553.370	96.412	649.782
Actual indicator - Average gross borrowing position - External Debt only	425.217	98.575	523.792
Actual indicator - Average gross borrowing position - External Debt plus PFI and similar arrangements	541.642	98.575	640.217

5.5 **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the trend in the cost of capital (borrowing and the cost of other long term obligations but net of investment income) against the Council's Budget Requirement (net revenue stream) for the General Fund and budgeted income for the HRA.

5.6 Both indicators show a reduction reflecting an overall fall in borrowing costs. Whilst the share of these costs is approximately equal (as reflected by the respective CFRs) the HRA has a lower net revenue stream and therefore the impact on the indicator is greater.

Rotherham MBC	**2010/11 Actual**	**2010/11 Revised Indicator**	**2010/11 Original Indicator**
Financing costs as a proportion of net revenue stream:			
Non HRA	8.61%	9.10%	10.14%
HRA	14.20%	15.07%	15.28%

5.7 **Incremental impact of Capital Investment Decisions –** Two indicators are used to highlight the trend in cost arising from changes to the Council's capital investment plans:

- the impact on Council Tax Band D levels as already budgeted for within the Council's MTFS of changes to the General Fund capital programme, and
- the impact on weekly rent levels arising from changes in the housing capital programme

Rotherham MBC	**2010/11 Actual**	**2010/11 Revised Indicator**	**2010/11 Original Indicator**
Incremental impact of capital investment decisions on the Band D council tax	£19.47	£21.04	£20.59
Incremental impact of capital investment decisions on the Housing Rent Levels	£0.00	£0.00	£0.00

The incremental impact of capital investment decisions on the Band D council tax shows a decrease over the original projection for 2010/11. This reflects the revenue implications in 2010/11 of the lower borrowing need. In addition the proactive treasury management activity carried over from 2009/10 and continued in 2010/11 resulted in a reduction in borrowing costs due to the Council utilising temporary cash flow funds instead of borrowing. As expected, there is no incremental impact of capital investment on HRA rent levels.

5.8 **Treasury Management Indicators and Limits on Activity**

5.8.1 **Upper limits on fixed and variable interest rates as at 31 March 2011** – These indicators identify the maximum limits for fixed interest rate gross debt and for variable interest rates based upon the debt position, net of investments. The table confirms the Council remained within the limits set.

Rotherham MBC	**2010/11 Actual**	**2010/11 Revised Indicator**	**2010/11 Original Indicator**	**2009/10 Actual**
Upper limit on fixed interest rates	83.96%	100%	100%	89.19%
Upper limit on variable interest rates based on net debt	26.18%	30%	30%	23.09%

Former SYCC	**2010/11 Actual**	**2010/11 Revised Indicator**	**2010/11 Original Indicator**	**2009/10 Actual**
Upper limit on fixed interest rates	100%	100%	100%	100%
Upper limit on variable interest rates based on net debt	0%	30%	30%	0%

5.8.2 **Maturity structure of fixed rate borrowing during 2010/11 –** These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. The position as at 31 March 2011 is shown in the table below.

	RMBC				
	Original Indicator %		**Revised Indicator %**		**Actual %**
	Lower	Upper	Lower	Upper	
Under 12 months	0	20	0	20	3.93
12 months to 2 years	0	25	0	25	4.45
2 years to 5 years	0	30	0	30	8.11
5 years to 10 years	0	35	0	35	15.70
10 years to 20 years	0	40	0	40	4.45
20 years to 30 years	0	45	0	45	6.11
30 years to 40 years	0	50	0	50	1.31
40 years to 50 years	10	60	10	60	22.62
50 years and above	30	100	15	100	33.28

	Former SYCC				
	Original Indicator %		**Revised Indicator %**		**Actual %**
	Lower	Upper	Lower	Upper	
Under 12 months	0	20	0	0	0
12 months to 2 years	0	25	0	0	0
2 years to 5 years	0	30	0	0	0
5 years to 10 years	0	35	0	0	0
10 years to 20 years	0	40	0	85	79.58
10 years t0 11 years	-	-	0	25	20.42
20 years to 30 years	0	45	-	-	-
30 years to 40 years	0	50	-	-	-
40 years to 50 years	10	60	-	-	-
50 years and above	30	100	-	-	-

5.8.3 **Maximum funds invested for more than 364 days** – This limit is set to reduce the need for early sale of an investment and is based on the availability of funds after each year end. The position as at 31 March 2011 for the Council is shown in the table below. The Former SYCC had no investments at that date.

Rotherham MBC	**2010/11 Actual £m**	**2010/11 Revised Indicator £m**	**2010/11 Original Indicator £m**
Maximum funds invested for longer than 364 days	0	12	12
Cash Deposits	0	12	12
N.b. The above excludes any Icelandic investments due to be recovered after more than 364 days (£1.94m)			

6. Actual debt management activity during 2010/11

6.1 **Borrowing** - The loans drawn by Rotherham MBC were:

Lender	**Principal**	**Type**	**Interest Rate**	**Maturity Years**	**Average rate**
PWLB	£10,000,000	Fixed rate	3.17%	7.5 Years	
PWLB	£5,000,000	Fixed rate	2.18%	5.75 Years	
PWLB	£5,000,000	Fixed rate	2.82%	8.42 Years	
PWLB	£20,000,000	Fixed rate	3.46%	10 Years*	
Total:	£40,000,000				3.15%
* This loan is repayable by equal instalments of principal over 10 years					

6.2 This compares with a budget assumption of net borrowing of £87.3million. As explained earlier (para. 4.4) the most prudent approach in 2010/11 was to continue to utilise temporary cash flow funds instead of borrowing when appropriate. And with long term rates remaining relatively high the borrowing undertaken was restricted to short term debt and to minimise the on-going interest rate risk within the portfolio the opportunity was taken to take out fixed rate debt.

The average rate compares favourably with a 4.34% average for all PWLB fixed rate debt in 2010/11.

6.3 **Rescheduling** – No rescheduling took place in 2010/11 due to unfavourable market conditions.

6.4 **Repayment** – Three loans matured during the year as shown in the table below and these were effectively replaced during the year by the debt referred to in 6.1. The additional debt taken out was broadly in line with the borrowing requirement for the year thus the Council's under-borrowed position was maintained.

Lender	Principal	Type	Interest Rate	Average rate
PWLB	£5,000,000	Fixed rate	4.22%	
PWLB	£5,000,000	Fixed rate	1.55%	
PWLB	£5,000,000	Fixed rate	4.27%	
Total:	£15,000,000			3.35%

6.5 **Summary of Debt Transactions** – The overall position of the debt activity resulted in a fall in the average interest rate of 0.10%, from 4.93% to 4.83%. This contributed to an overall breakeven position on the capital financing budget when compared to the estimate.

6.6 **Former South Yorkshire County Council**, – One loan matured and there was no new borrowing or rescheduling during 2010/11

Lender	Principal	Type	Interest Rate
PWLB	£5,600,000	Fixed rate	4.33%

7. Investment Position

7.1 **Investment Policy –** The Council's investment policy is governed by DCLG Guidance, which was implemented in the annual investment strategy approved by Council on 3 March 2010. The investment activity during the year conformed to the approved strategy.

The Council maintained an average balance of £19.0m and received an average return of 0.44%. This outturn position compares with a budget assumption of an average of £24.1m investment balances at a 1.50% interest rate.

The average return was lower than the estimate due to the lower investment balances and the continued reduced investment returns available. When compared to the local measure of performance the average return was marginally above the average 7 day LIBID rate for 2010/11 of 0.43%.

8. Regulatory Framework, Risk and Performance

8.1 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; and
- 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.

8.2 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, the adoption and implementation of the Prudential Code and the Code of Practice for Treasury Management means that its capital expenditure is prudent, affordable and sustainable. Treasury investment practices are governed by the primary objectives of security ahead of liquidity and then yield. Revised operational guidelines enhanced the weighting towards security still further at the expense of yield or return.