ROTHERHAM BOROUGH COUNCIL – REPORT TO MEMBERS

1.	**Meeting:**	**Audit Committee**
2.	**Date:**	**26th September 2012**
3.	**Title:**	**Annual Treasury Management Report and Actual Prudential Indicators 2011/12**
4.	**Directorate:**	**Resources**

5. Summary

The Council received an annual treasury strategy in advance of the 2011/12 financial year and also received a mid year report representing a mid year review of treasury activity.

The annual treasury management report is the final treasury report for 2011/12 Its purpose is to review the treasury activity for 2011/12 against the strategy agreed at the start of the year. The report also covers the actual Prudential Indicators for 2011/12 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.

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 Resources 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 (as updated 2011)
CIPFA – Prudential Code (as updated 2011)

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Annual Report on the Treasury Management Service and Actual Prudential Indicators 2011/12

Executive Summary

During 2011/12 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 2011/12, with comparators, are as follows:

	2011/12 Actual £m	**2011/12 Revised Indicator £m**	**2011/12 Original Indicator £m**	**2010/11 Actual £m**
Capital Expenditure	93.983	102.262	63.911	99.635
Capital Financing Requirement: - Non-HRA	323.461	325.687	312.079	294.410
Capital Financing Requirement: - HRA	288.771	288.791	290.460	284.865
HRA Settlement	15.188	15.188	-	-
Total excluding PFI and similar arrangements	627.420	629.666	602.539	579.276
Cumulative adjustment for PFI and similar arrangements	131.343	142.141	114.146	115.379
Total including PFI schemes and similar arrangements	758.763	771.807	716.685	694.655
	%	%	%	%
Financing Costs as a proportion of Net Revenue Stream: Non-HRA	7.99	9.20	9.90	8.61
HRA	13.75	13.98	15.78	14.20

The main reasons for the change in the actual indicators, from those originally set in March 2011 and subsequently revised in March 2012 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 Resources 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 2012, the Council's external debt totalled £471.540m (£437.636m at 31 March 2011) and its investments totalled £1.921m (£2.846m at 31 March 2011).

At 31 March 2012, the Former South Yorkshire County Council external debt totalled £96.412m (£96.412m at 31 March 2011). The Former SYCC had no investments at that date (nil at 31 March 2011).

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.

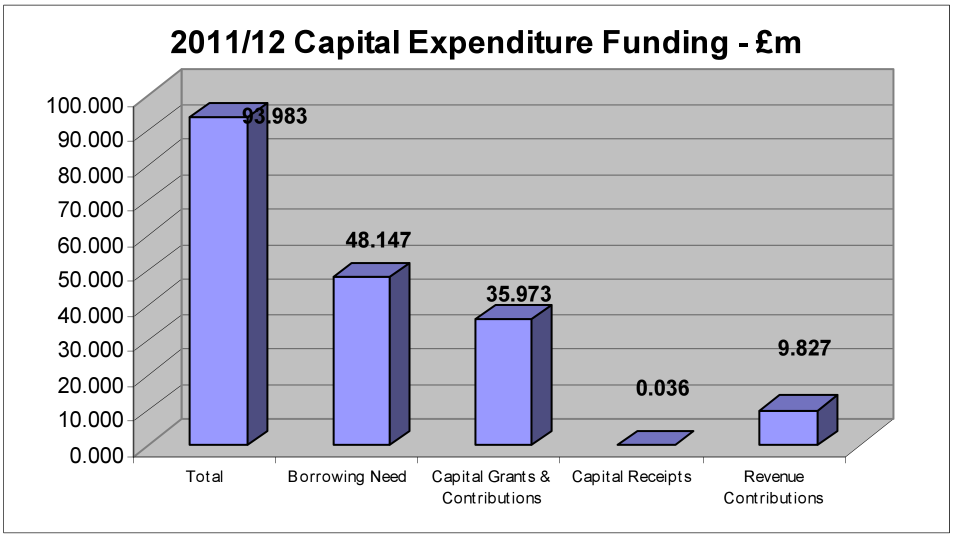
2. The Council's Capital Expenditure and Financing 2011/12

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 2011/12 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, in considering the 2012/13 Treasury Management strategy at its meeting on 7 March 2012, approved the following revised MRP policy in relation to the charges for 2011/12 and 2012/13:

(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. The calculation of the provision will be either the annuity method or the equal instalments method depending on which is most appropriate; 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 the specified period(s) set down within the regulations. The calculation of the provision will be either the annuity method or the equal instalments method depending on which is most appropriate.

3.3 In addition to showing the Council's underlying borrowing need, following changes to accounting rules in 2009/10, the CFR also includes other long term liabilities which have been brought on balance sheet, for example, PFI schemes and finance lease assets. A further one off adjustment has also been made this year as a result of HRA reform which led to the Council paying CLG £15.188m in March 2012.

CFR (£m)	31 March 2012 Actual £m	31 March 2012 Revised Indicator £m	31 March 2012 Original Indicator £m	31 March 2011 Actual £m
Opening balance (excluding on-balance sheet PFI and similar arrangements)	579.276	579.276	586.072	550.405
Plus increase in borrowing need	41.562	43.729	27.339	38.327
Less MRP/VRP/Met Debt Principal Repayment	-8.606	-8.606	-10.872	-9.456
HRA settlement	15.188	15.188	-	-
Closing balance (excluding on-balance sheet PFI and similar arrangements)	627.420	629.587	602.539	579.276
Closing balance (excluding on-balance sheet PFI and similar arrangements)	**627.420**	**629.587**	**602.539**	**579.276**
Plus cumulative PFI adjustments	131.343	142.220	114.146	115.379
Closing balance (including on-balance sheet PFI and similar arrangements)	**758.763**	**771.807**	**716.685**	**694.655**

3.4 Actual capital expenditure in 2011/12 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 2012

4.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Strategic Director of Resources 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 2011/12 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 2011 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 2012 compared with the previous year was:

RMBC Treasury position	**31 March 2012**		**31 March 2011**	
	Principal £m	**Average Rate %**	**Principal £m**	**Average Rate %**
Fixed Interest Rate Debt *	355.540	4.94	326.636	5.07
Variable Interest Rate Debt **	116.000	4.09	111.000	4.13
Total Debt	471.540	4.73	437.636	4.83
Fixed Interest Investments	1.921	*** 0.00	2.846	*** 0.00
Variable Interest Investments	0	0.00	0	0.00
Total Investments	1.921	0.00	2.846	0.00
Net borrowing position	**469.619**		**434.790**	

* 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 (£627.420m), the Council's outstanding debt levels (£471.540m) are lower than this Requirement by approximately £156m 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 2012 compared with the previous year was:

Former SYCC Treasury position	**31 March 2012**		**31 March 2011**	
	Principal £m	**Average Rate %**	**Principal £m**	**Average Rate %**
Fixed Interest Rate Debt *	96.412	5.92	96.412	5.92
Variable Interest Rate Debt **	0	0.00	0	0.00
Total Debt	96.412	5.92	96.412	5.92
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**		**96.412**	

* 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 2011/12 plus the expected changes to the CFR over 2012/13 and 2013/14. 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 2012 Actual £m	31 March 2012 Revised Indicator £m	31 March 2012 Original Indicator £m	31 March 2011 Actual £m
Net borrowing position	469.619	481.664	464.103	434.790
CFR (excluding PFI and similar arrangements)	627.420	629.587	602.539	579.275

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 2011/12 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	729.518	96.412	825.930
Revised Indicator – Authorised Limit	790.334	100.000	890.334
Actual indicator – Maximum gross borrowing position – External Debt only	496.990	96.412	593.402
Actual indicator - Maximum gross borrowing position – External Debt plus PFI and similar arrangements	653.383	96.412	749.795

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 2011/12 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	611.837	96.412	708.249
Revised Indicator - Operational Boundary	660.661	96.412	757.073
Actual indicator - Average gross borrowing position - External Debt only	447.877	96.412	544.289
Actual indicator - Average gross borrowing position - External Debt plus PFI and similar arrangements	602.717	96.412	699.129

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	**2011/12 Actual**	**2011/12 Revised Indicator**	**2011/12 Original Indicator**
Financing costs as a proportion of net revenue stream:			
Non HRA	7.99	9.20	9.90
HRA	13.75	13.98	15.78

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	2011/12 Actual	2011/12 Revised Indicator	2011/12 Original Indicator
Incremental impact of capital investment decisions on the Band D council tax	£25.09	£25.34	£23.73
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 is in line with the revised indicator. This reflects the fact that the actual borrowing need in 2011/12 is consistent with the revised forecast. 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 2012** – 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	2011/12 Actual	2011/12 Revised Indicator	2011/12 Original Indicator	2010/11 Actual
Upper limit on fixed interest rates	81.69%	100%	100%	83.96%
Upper limit on variable interest rates based on net debt	25.36%	30%	30%	26.18%

Former SYCC	2011/12 Actual	2011/12 Revised Indicator	2011/12 Original Indicator	2010/11 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 2011/12 –** 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 2012 is shown in the table below.

	RMBC				
	Original Indicator %		Revised Indicator %		Actual %
	Lower	Upper	Lower	Upper	
Under 12 months	0	20	0	20	2.01
12 months to 2 years	0	25	0	25	0.60
2 years to 5 years	0	30	0	30	14.47
5 years to 10 years	0	35	0	35	15.18
10 years to 20 years	0	40	0	40	9.14
20 years to 30 years	0	45	0	45	9.86
30 years to 40 years	0	50	0	50	2.89
40 years to 50 years	10	60	10	60	22.80
50 years and above	15	100	15	100	23.05

	Former SYCC				
	Original Indicator %		Revised Indicator %		Actual %
	Lower	Upper	Lower	Upper	
Under 12 months	0	50	0	50	0
12 months to 2 years	0	70	0	70	0
2 years to 5 years	0	100	0	100	20.13
5 years to 10 years	0	100	0	100	79.87
10 years to 20 years	-	-	-	-	-

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 2012 for the Council is shown in the table below. The Former SYCC had no investments at that date.

Rotherham MBC	2011/12 Actual £m	2011/12 Revised Indicator £m	2011/12 Original Indicator £m
Maximum funds invested for longer than 364 days	0	10	10
Cash Deposits	0	10	10
N.B :. The above excludes any Icelandic investments due to be recovered after more than 364 days (£1.498m)			

6. Actual debt management activity during 2011/12

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	3.01%	8 Years	
PWLB	£10,000,000	Fixed rate	3.20%	9 Years	
PWLB	£10,000,000	Fixed rate	3.37%	11 Years	
PWLB	£5,000,000	Fixed rate	3.26%	19 Years	
PWLB	£5,000,000	Fixed rate	3.37%	22 Years	
PWLB	£5,188,000	Fixed rate	3.44%	25 Years	
PWLB	£1,000,000	Fixed rate	4.76%	25 Years*	
PWLB	£1,000,000	Fixed rate	4.24%	25 Years*	
PWLB	£1,000,000	Fixed rate	4.08%	25 Years*	
PWLB	£2,000,000	Fixed rate	3.66%	25 Years*	
PWLB	£750,000	Fixed rate	3.79%	25 Years*	
Total:	£50,938,000				3.34%
* This loan is an annuity repayable over 25 years					

6.2 This compares with a budget assumption of net borrowing of £56.5million. As explained earlier (para. 4.4) the most prudent approach in 2011/12 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 4.18% average for all PWLB fixed rate debt in 2011/12.

6.3 **Rescheduling** – No rescheduling took place in 2011/12 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	£2,000,000	Fixed rate	3.46%	
PWLB	£5,000,000	Fixed rate	3.99%	
PWLB	£10,000,000	Fixed rate	2.11%	
PWLB Annuity	£33,858	Annual repayments		
Total:	£17,033,858			2.82%

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 4.83% to 4.73%. This contributed to an overall breakeven position on the capital financing budget when compared to the estimate.

6.6 **Former South Yorkshire County Council**, – There were no repayments, no new borrowing and no rescheduling during 2011/12.

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 2 March 2011. The investment activity during the year conformed to the approved strategy.

The Council maintained an average balance of £9.5m and received an average return of 0.33%. This outturn position compares with a budget assumption of an average of £20m investment balances at a 0.50% 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 below the average 7 day LIBID rate for 2011/12 of 0.48%.

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.