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Flintshire
COUNTY COUNCIL

FLINTSHIRE COUNTY COUNCIL

TREASURY MANAGEMENT

DRAFT

ANNUAL REPORT 2011/12

1.00 INTRODUCTION

1.01 The Council approved the Treasury Management Policy and Strategy Statement (Policy Statement) 2011/12 including key indicators, limits and an annual investment strategy on 1st March 2011.

1.02 The Policy Statement was produced based on the 2009 edition of the CIPFA Treasury Management in the Public Services: Code of Practice.

1.03 The purpose of this report is to review the outcomes from 2011/12 treasury management operations and compare with the Policy Statement.

2.00 TREASURY MANAGEMENT COMPLIANCE STATEMENT 2011/12

2.01 Treasury management comprises the management of the local authority's 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.

2.02 All treasury management activity undertaken during 2011/12 complied with the approved Policy and Strategy Statement 2011/12, the CIPFA Code of Practice 2009, and the relevant legislative provisions.

2.03 The Authority's current policy is to appoint an external consultant to advise on its treasury management function. The external adviser is Sterling Consultancy Services.

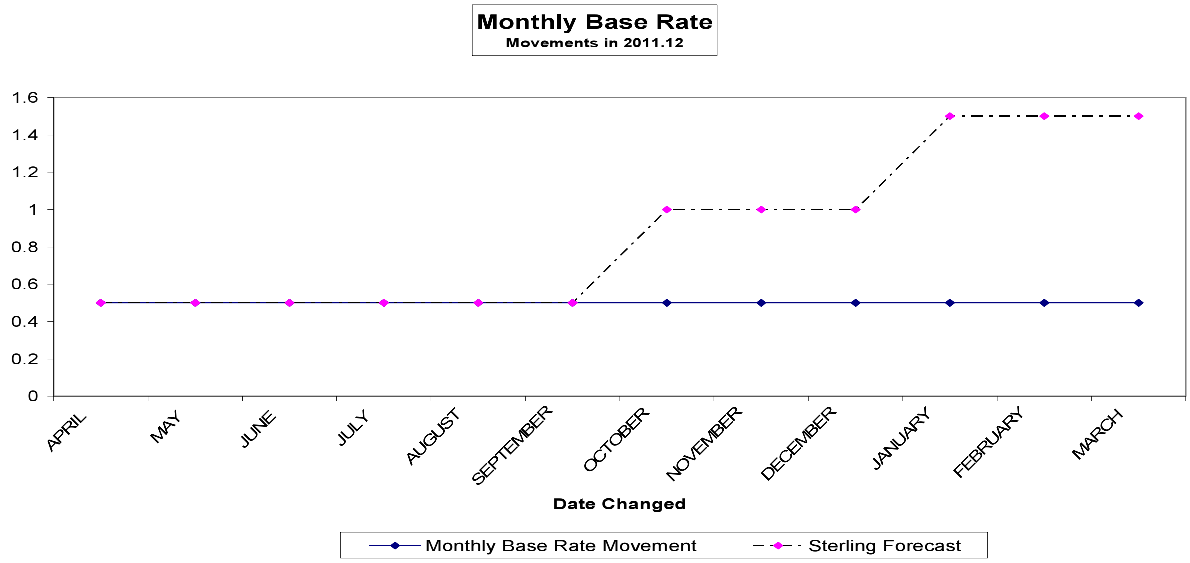
3.00 ECONOMIC & INTEREST RATE REVIEW 2011/12

3.01 The UK base rate remained at 0.50% throughout 2011/12.

3.02 The 2011/12 maximum and minimum PWLB rates for fixed maturity loans were:

Period	Maximum	Minimum	31/03/2012
4 to 5 years	3.73%	1.81%	2.05%
9 to 10 years	4.89%	2.90%	3.21%
10 to 15 years	5.29%	3.05%	3.85%
15 to 25 years	5.44%	3.54%	4.32%

3.03 The graph below shows the movement in U.K. base rate during 2011/12 and Sterling’s November 2010 forecast for 2011/12 upon which the Strategy was based. As can be seen from the graph, the forecasted rise in Base Rate to 1.5% did not materialise, as interest rates have remained lower for longer than generally forecast. Sterling provided revisions to this forecast during the year and their review of the year follows.



3.04 Annual Review 2011/12 by Sterling Consultancy Services

The Eurozone debt crisis dominated the financial year 2011/12. The apparent inability of leaders to either agree on remedial policies or implement fiscal consolidation measures prompted frequent bouts of market volatility, exacerbated by multiple sovereign rating downgrades, as investors positioned themselves for potential government defaults or even the break-up of the Eurozone itself. Investor confidence in struggling Eurozone nations, such as Greece, Italy and Spain, dived, prompting sharp upward movements in government borrowing rates. This pressure toppled a number of political leaders, culminating in the appointment of unelected technocrats in Greece and Italy to ensure these countries implemented austerity measures. Greece, unable to access financial markets for funding, was bailed out for a second time, a requirement of which was a selective default on private sector-owned bonds.

Exposure to the Eurozone periphery and new regulation reducing the probability of government support placed downward pressure on the creditworthiness of many European banks, prompting a raft of credit rating downgrades and sharp rises in Credit Default Swap (CDS) spreads. This led to an increase in funding costs, as wholesale interbank lending rates rose sharply above policy rates. Dexia, a banking group based in Belgium, France and Luxembourg was the main casualty, but was bailed out and broken up by the respective governments. Two Danish banks failed, while Spain forced its regional banking sector to consolidate.

The European Central Bank (ECB) pulled the Eurozone back from the brink in late December. The central bank cut interest rates and flooded the Eurozone banking sector with cheap long-term loans, immediately reducing the near-term risk of a liquidity crisis and temporarily calming financial markets. The action had a marked impact on Eurozone wholesale interbank lending rates; 3-month Euribor declined from 1.34% at the start of December to 0.77% at the end of March. The decline in funding rates for UK banks was less significant, but 3-month LIBOR still fell from 1.08% to 1.03%. Unfortunately, the ECB action could not prevent the debt crisis causing a sharp decline in household and business confidence, eventually pushing the Eurozone into recession.

The UK's reliance on the Eurozone as a major trading partner was illustrated when the country followed the Eurozone into recession over the last six months of the financial year. Other factors responsible for the fall in economic activity included the government's deficit reduction programme and the weakness in household and business spending. The decline in household spending was the result of low confidence and the erosion of disposable income by persistently elevated inflation, subdued wage growth, higher taxes and rising unemployment. Businesses were in a similarly weak position, with access to credit restricted or too expensive due to a risk-averse banking sector, and subdued domestic and foreign demand.

Weakening economic growth and signs of further deterioration in the Eurozone prompted the Bank of England to loosen monetary policy in October, despite above target inflation. With Bank Rate already at 0.5%, the Monetary Policy Committee (MPC) voted for a further £50bn of quantitative easing (QE), which, in addition to safe haven buying, helped push gilt yields to record lows over the next few months. Policymakers justified the action because they were confident inflation would fall quickly back to target during 2012. However, although the annual Consumer Price Index (CPI) rate declined from the September peak of 5.2%, a combination of higher crude oil and food prices caused the rate to rise slightly in March to 3.5%, leaving Bank of England policymakers in the unenviable position of setting policy to battle both weak growth and high inflation.

4.00 TREASURY MANAGEMENT ACTIVITIES DURING 2011/12

4.01 The following were the main treasury activities during 2011/12:

- The Head of Finance received a monthly update on Treasury activities.
- The Council received a Mid Year Report on 22nd November 2011.
- Quarterly updates reports were presented to the Audit Committee including the Icelandic monies at risk (see paragraph 7).
- All Members were invited to a training session undertaken by Sterling Consultancy Services on 17th January 2012, which was hosted by Audit Committee.
- The new Policy and Strategy Statement 2012/13 was approved by Council on 1st March 2012.

- The Council continues to be an active member of both the CIPFA Treasury Management Forum and the CIPFA Benchmarking Club.
- The Council's cash flow was managed on a daily basis. During the year the Authority acted both as a borrower and as a lender and was a net borrower over the year in question. The maximum investments the Authority had on deposit at any one time was £84.4m and the maximum long-term borrowing at any one time was £173.6m. The average investment balance was £70.9m.

4.02 At the time of writing the 2011/12 Treasury Management Policy Statement (the Policy) in early 2011, it was hoped that the global financial environment was starting to stabilise and this confidence was reflected in the implementation of the Policy in the first quarter of 2011/12. The Audit Committee report of 13th July 2011, listed the main activities for members including two long term investments both at an interest rate of 2.65% which boosted the average interest rate to over 1% compared to 0.8% in 2010/11.

4.03 Unfortunately, this optimism was short lived as the risks of a sovereign debt default by Greece and the potential knock on effects to financial stability re-surfaced. Sterling, the Council's advisers, changed the counterparty credit risk marker to a 'red flag' status and immediate action was taken to de-risk the approach. As reported to Audit Committee of 14th December 2011, from early September 2011 in anticipation of further deterioration of market conditions, the following investment practices were followed:

- Money 'on call' with banks
- Deposits with other local authorities
- Use of AAA Money Market Funds
- Use of the Debt Management Office

4.04 This approach was still within the Treasury Management Strategy, however some distance from the planned approach outlined in the Policy. The above low risk approach did mean that the average interest rate would reduce.

4.05 By the time of the Audit Committee report of 26th March 2012, the red flag status had been removed to an 'amber status' following steps taken by European policy makers to alleviate some of the risks. The restriction of only having money on call was lifted and as a first step deposits could be made with banks and buildings societies on the Council's counterparty list for up to 3 months, thus marginally increasing the interest rate that could be achieved. This continues to be the position in 2012/13.

5.00 TREASURY MANAGEMENT DEBT STRATEGY

5.01 The total long term debt outstanding, brought forward into 2012/13 totalled £173.6

million. Loans with the Public Works Loans Board were in the form of fixed rate (£144.66m) and variable rate (£10m). The remaining £18.95m was variable in the form of Lobo's (Lender's Option, Borrower's Option). The Council's average borrowing rate throughout the year was 5.43%.

5.02 The Debt Strategy as stated in the Policy Statement 2011/12 and outcomes are recorded below:

(1) To effect borrowing required in 2011/12 at the cheapest cost commensurate with future risk based on interest rate forecasts outlined in the strategy statement

For a number of years the Council has not taken any new long term borrowing and used available cash reserves to fund capital expenditure as the most financially effective means of financing. No borrowing was required during 2011/12.

(2) The Head of Finance will keep under review, along with its Treasury Consultants; the opportunities which may arise for restructuring the Council's debt in order to take advantage of potential savings as interest rates change and to enhance the balance of the long term portfolio (amend the maturity profile and/or the balance of volatility). Any actions carried out under delegated powers will be reported to the Cabinet and County Council as appropriate.

Debt was reviewed throughout the year. No debt-restructuring opportunities arose.

(3) To manage the Council's debt maturity profile, i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing with the limits stated within the strategy statement.

The debt maturity profile as at 31 March 2012 is shown on page 11. This shows a debt maturity profile in line with CIPFA's recommendations of having no more than 10% of the debt portfolio maturing in any one future year. The Council remained within the approved Prudential Limits for Debt Maturity.

(4) To monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movements, within the limits stated in the strategy statement.

The Council had one variable PWLB rate loan during 2011/12. The interest rate on this loan varied between 0.59% - 0.71% during the year. The interest rate on the Council's LOBOs can be increased by the lender but the Council has the opportunity to repay. As forecast, this event did not occur in 2011/12 as market rates remain low. The Council remained within the approved Prudential Limits for Variable Interest Rate Exposure.

6.00 TREASURY MANAGEMENT INVESTMENT STRATEGY

6.01 The Council's investment strategy during 2011/12 was:

Investments will be made in accordance with the Guidance on Local Government Investments issued by the Welsh Government under section 15(1)(a) of the Local Government Act 2003, and with the institutions identified in the authorised lending list. Investments will be made with the aim of meeting cash flow requirements whilst achieving a level of return greater than would be secured by internal investment and maintaining capital security and policy flexibility.

6.02 Investment transactions totalled £252.4m in 2011/12 with interest earned amounting to £635k on an average balance of £70.9m. The weighted average temporary investment rate obtained in the year was 0.9%. This compares with the Policy Statement which assumed an average rate of 1.00% on an average balance of around £60m, estimating income of £590k. A full list of transactions undertaken during the year is available in the background papers. All investments were made in accordance with the Treasury Management Policy & Strategy Statement 2011/12.

6.03 The weighted average temporary investment rate obtained in the year of 0.9% is higher than the seven day LIBID rate of 0.48% which is a proxy of a return without effective cash flow management.

6.04 No temporary borrowing costs were incurred during 2011/12 which is a measure of the accuracy of short term cash flow management.

6.05 The maturity of investments was regularly reviewed with the aim of maximising returns whilst managing the risk of future interest rate movements and counterparty risk. As at 31st March 2012, the maturity of investments is shown in the table below:

<table>
<tr><th>Maturity Due</th><th>Actual %</th><th>Forecast %</th></tr>
<tr><td>< 1 month</td><td>55.0%</td><td>35%</td></tr>
<tr><td>1 – 3 months</td><td>16.9%</td><td rowspan="2">55%</td></tr>
<tr><td>3 – 12 months</td><td>19.9%</td></tr>
<tr><td>> 12 months</td><td>3.6%</td><td rowspan="2">10%</td></tr>
<tr><td>Icelandic Investments</td><td>4.6%</td></tr>
</table>

The table above only illustrates the position as at 31st March 2012. The percentages fluctuated throughout the year but marginally more cash was held short term than forecast following the red credit risk alert from Sterling in September 2011 as explained in paragraphs 4.02 to 4.05.

6.06 The Investment Strategy set a Prudential Limit of £40 million for non-specified investments. In 2011/12, non-specified investments were limited to investments over 364 days including forward deals with counterparties which meet the credit rating criteria and Money Market Funds. As part of this strategy, the following longer term investments were made during 2011/12.

Amount (£)	**Counterparty**	**Date From**	**Date to**	**Period (days)**	**Interest rate (%)**
£2 million	Bank of Scotland	09/05/11	27/07/12	445	2.65
£2 million	Bank of Scotland	02/05/11	27/07/12	434	2.65
£2 million	Doncaster MBC	30/10/11	16/04/13	561	1.3

6.07 Cash balances in relation to other Funds were utilised in the year and interest was paid at the following rates and times as stated in the Treasury Management Practices –

- Education Trust Funds – base rate, annually
- Optec Youth Exchange Fund – average monthly rate, quarterly
- Insurance Fund – average seven day rate, annually
- Education Delegated Fund – average seven day rate, annually

6.08 It is Council policy to minimise daily cash flow balances. However, on certain occasions it is uneconomic to deal (below £200,000) and therefore, the balance is kept in the bank account.

7.00 LANDSBANKI INVESTMENTS - UPDATE

7.01 On 7th October 2008, Landsbanki was placed in receivership. At that time Flintshire had £3.7 million of Council monies invested with the UK subsidiary. The investments were made as follows –

£1.2 million maturing 17th October 2008 (invested on 22nd July 2008)
£1.5 million maturing 14th November 2008 (invested on 1st September 2008)
£1.0 million maturing 18th November 2008 (invested on 8th September 2008)

7.02 In late 2011, it was confirmed that Priority status had been upheld by the Icelandic Supreme Court, with Local Authority Investors, including Flintshire County Council, being recognised as preferential creditors. The Winding Up Board of Landsbanki made a distribution to priority creditors on 17th February 2012. Flintshire received £1,087,776.79 of the £3.7million original investment. In March 2012, the Winding Up board announced that recoveries in the Landsbanki Administration would now likely be 100% of their deposits, subject to potential future exchange rate fluctuations. Although this is only a forecast and not guaranteed, it is marginally higher than the 95% previously forecast. The impact on Flintshire County Council will not be known until the final distribution is made.

7.03 The future pattern of distributions is not known. The 2011/12 accounts were to be closed taking account of the guidance from the Wales Audit Office and CIPFA. It was therefore assumed for accounting purposes that the repayment would be made as follows –

Date	%
December 2012	8.00
December 2013	8.00
December 2014	8.00
December 2015	8.00
December 2016	8.00
December 2017	8.00
December 2018	22.00
Total	**70.00**

7.04 However, a further distribution of £458,173.80 was made on 29th May 2012. We are awaiting further guidance on how future distributions should be accounted for.

7.05 Council Officers have been and continue to provide information to assist the Local Government Association (LGA), Welsh Local Government Association (WLGA) and other bodies who are seeking to recover investments.

8.00 PERFORMANCE COMPARISON WITH TREASURY MANAGEMENT INDICATORS

8.01 Flintshire County Council is a member of the CIPFA Treasury Management Benchmarking Club. The draft 2011/12 report compared the Council with 57 other authorities. The final report will be issued at the end of June 2012. Whilst this benchmarking information assists in reviewing comparative performance, it must be recognised that not all Councils are in the comparison (57 out of several hundred) and that the size of Councils and their historic Treasury Management positions do not provide comparable situations and so results from benchmarking need to be reviewed with care. The data provided showed that the weighted average long term borrowing rate for Flintshire of 5.4% was higher than the benchmarking group average of 4.5%. The reason for this difference reflects the Council's historic borrowing and no new borrowing since 2001/02 where rates have been lower. The weighted average investment rate was 0.9% compared with the benchmarking group average of 1.2%. The main reasons for the lower average rate are:

- Average investment balance of the benchmarking group is over £87m compared with £70.9m for the Council. These higher balances may assist larger councils with access to counterparties and better rates for longer periods.
- The average term in days for fixed investments less than 365 days was 54 days for the Council compared with 92 days for the group.

8.02 As explained in section 4, a very low risk appetite was followed in the second half of 2011, which reduced the average interest rate achievable.

8.03 The table below compares actual rates achieved with the benchmarking rates as stated in our Treasury Management Practices. Despite the low risk approach, the rate achieved was above 3 month LIBID (London Interbank Bid Rate).

	2011/12 ACTUAL	7 DAY LIBID	3 MONTH LIBID	BENCHMARK
INVESTMENTS	0.9%	0.5%	0.8%	-
BORROWING	5.4%	-	-	4.5%

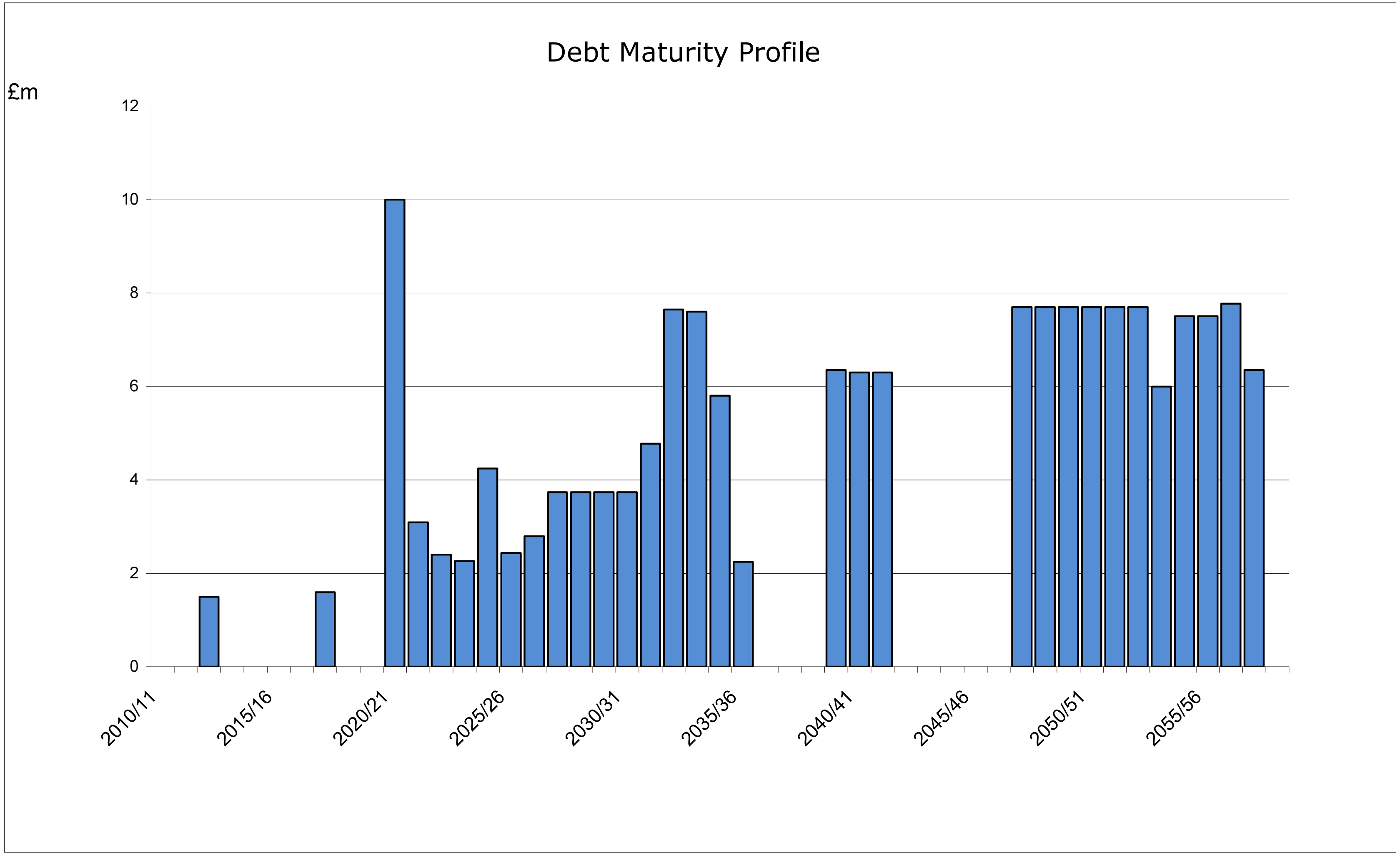
9.00 CONCLUSION

9.01 The treasury management function has operated within the statutory and local limits detailed in the 2011/12 Treasury Management Policy Statement.

9.02 There is a Policy Statement adopted for 2012/13 which was revised from the 2011/12 statement, with the view of continuing to improve performance by managing the various treasury risks.

9.03 The financial environment within which the treasury function operates remains challenging and this is likely to continue for the foreseeable future.

9.04 The Policy was implemented in a pro-active manner with security and liquidity as the focus.



Debt Maturity Profile
£m
12
10
8
6
4
2
0
2010/11
2015/16
2020/21
2025/26
2030/31
2035/36
2040/41
2045/46
2050/51
2055/56