Division(s): N/A

COPY

Cabinet – 17 JULY 2012

TREASURY MANAGEMENT OUTTURN 2011/12

Report by Assistant Chief Executive and Chief Finance Officer

Introduction

1. The Chartered Institute of Public Finance and Accountancy's (CIPFA's) 'Code of Practice on Treasury Management (Revised) 2009' requires that Council (via Cabinet) and Audit Committee receives an updated report on Treasury Management activities at least twice per year. This report is the second report for the financial year 2011/12 and sets out the position as at 31 March 2012.

2. The following annexes are attached

Annex 1	Debt Financing 2011/12
Annex 2	PWLB Maturing
Annex 3	Lending List Changes
Annex 4	Investment portfolio 31/03/2012
Annex 5	Prudential Indicators Outturn
Annex 6	Benchmarking

Strategy 2011/12

3. The Treasury Management Strategy for 2011/12 was based on an average base rate forecast of 0.75%. The budget for interest receivable assumed that an average interest rate of 1.15% would be achieved, 0.40% above base rate.

4. The Strategy for Long Term Borrowing was to continue to have the option to fund new or replacement borrowing up to the value of 25% of the portfolio through internal borrowing to reduce the Council's exposure to credit risk and reduce the cost of carry (difference between borrowing costs and investment returns) whilst debt rates remained higher than investment interest rates.

5. The Strategy included the continued use of the services of external fund managers, Scottish Widows Investment Partnership (SWIP) and Investec.

Market Background

6. At the time of determining the strategy for 2011/12, the Bank of England base rate was forecast to remain historically low but to gradually increase and to average 0.75% over the year. In reality, the base rate remained at 0.5% throughout 2011/12 bringing the total period without a base rate change to 36 months at year end.

7. During 2011/12 the coalition government continued to plan to bring down government borrowing while also emphasising the need for growth. In the face of other European sovereign weakness UK government Gilts have continued to benefit from their relative 'safe haven' status and the cost of borrowing has remained low for the UK government. 5-year and 10-year gilt yields fell to lows of 0.94% and 2.0% respectively.

8. The Bank of England continued to pursue a policy of Quantitative Easing (QE), under which it bought up £325bn of government bonds. This was intended to inject liquidity into banks and act as a stimulus for banks to extend credit to other banks and businesses.

9. However, poor growth, particularly in the construction industry, resulted in the economy falling into a technical double dip recession in the fourth quarter of 2011/12.

10. CPI Inflation spiked up to 5.2% in September 2011 before falling to 3.5% by year end as the impact of the increase in VAT in January 2011 fell out. At year end, inflation was still above the Bank of England's target rate of 2%.

11. In the wider European and Global context, the US Federal Reserve (the Fed) kept the official interest rate at 0.25% where it has been since December 2008. The European Central Bank increased rates from 1% to 1.25% in April 2011 before rates were reduced to 1% again in December 2011.

12. By the beginning of 2011/12, the credit crisis had migrated from banks to European sovereigns. The ratings of Ireland and Portugal had been downgraded to the BBB category, Greece had been downgraded to sub-investment grade and Spain had also been downgraded but remained in the AA category.

13. During 2011/12, the failure of the Greek government to successfully implement austerity measures in line with the terms of the second bailout package, which had been agreed with Euro Zone leaders in July 2011, made the threat of Greek withdrawal from the Euro a real possibility.

14. The difficulty in quantifying the potential impact of sovereign and institutional exposure to the Euro Zone crisis led to a Europe wide lack of confidence in banking institutions and the ability of governments to support them. During the year all three of the major ratings agencies placed European sovereigns, including non-Euro Zone members, on ratings watch.

Treasury Management Activity

Debt Financing

15. The Council's debt financing position for 2011/12 is shown in Annex 1.

16. The option to fund new or replacement borrowing requirements from internal balances, up to the value of 25% of the investment portfolio was retained in the 2011/12 annual treasury management strategy. This was intended to reduce the cost of carry of borrowing which is the difference between borrowing rates and investment returns.

17. No new borrowing has been arranged during 2011/12 with either the PWLB or through the money markets.

18. At 31 March 2012, the authority had 71 PWLB loans totalling £370.73m and 10 LOBO[1] loans totalling £50m. The average rate of interest paid on PWLB debt was 4.62% and the average cost of LOBO debt in 2011/12 was 3.95%. The combined weighted average for interest paid on long-term debt was 4.54%.

Maturing Debt

19. The Council repaid £13.686 million of maturing PWLB loans during the year. The weighted average interest rate payable on the matured loans was 7.62%. The details are set out in Annex 2.

Debt Restructuring

20. No long term debt was restructured during 2011/12.

Investment Strategy

21. Security and liquidity of cash was prioritised above the requirement to maximise returns. The Council adopted a cautious approach to lending to financial institutions, and continuously monitored credit quality information regarding the institutions on the Lending List.

22. During 2011/12 the Council limited the exposure to banks by increasing lending to local authorities deemed to be of high credit quality. At 31 March 2012 the Council had £67m of long term fixed deposits (deposits over 364 days), of which £57m was placed with local authorities or police authorities.

23. The aim of this was to maintain yield while increasing the security of deposits and reducing the exposure to interest rate and counterparty risk in an environment where interest rates are expected to stay low or to fall over the medium term.

24. Most deposits placed with Local Authorities were between one and three years in length. Taking into account all fixed term deposits during 2011/12, the weighted average maturity of deposits was 300 days.

25. The weighted average maturity of all deposits at 31 March 2012, including money deposited overnight, was 282 days (compared with 110 days during 2010/11). This comprised £196m fixed deposits with a weighted average maturity of 390 days and £76m held on overnight deposit at 1 day notice.

26. The Council used fixed and structured deposits, as well as call accounts, money market funds and short dated bond funds to deposit its in-house temporary cash surpluses during 2011/12.

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[1] LOBO (Lender's Option/Borrower's Option) Loans are long-term loans which include a re-pricing option for the bank at predetermined intervals.

27. In compliance with the latest CIPFA guidance on deposits held with Icelandic banks, the 2011/12 final accounts include an impairment for the potential lost interest on amounts placed with Landsbanki. During 2011/12 the preferential status of local authority claimants was confirmed and the first distribution was received from the winding up board. It is now understood that authorities should receive 100% of their claim, although the timings of future distributions are unknown.

The Council's Lending List

28. The Council's in-house cash balances are deposited with institutions that meet the Council's approved credit rating criteria. The approved Lending List is regularly updated during the year to reflect changes in bank and building society credit ratings. Changes are reported to Cabinet each month. The approved lending list may also be further restricted by officers, in response to changing conditions and perceived risk. Annex 3 shows the amendments incorporated into the Lending List during 2011/12, in accordance with the approved credit rating criteria and additional temporary restrictions.

Investment Outturn

29. The average daily balance of temporary surplus cash invested in-house was £260m in 2011/12. The Council achieved an average in-house return for the year of 1.12%, producing gross interest receivable of £2.928m (excluding interest accrued on Landsbanki deposits). Temporary surplus cash balances include: developer contributions; council reserves and balances; trust fund balances; and various other funds to which the Council pays interest at each financial year end, based on the average rate earned on all deposits.

30. In 2011/12 the Council changed the benchmark, against which its own in-house investment performance is measured, from the seven-day inter-bank sterling rate to the three month inter-bank sterling rate. The three month rate better reflects the maturity profile of the Council's investment portfolio and therefore provides a more meaningful comparator.

31. During 2011/12 the average three month inter-bank sterling rate was 0.81%. The Council's average in-house return of 1.12% exceeded this benchmark by 0.31%.

32. Due to the lower than forecast base rate and unfavourable market conditions the average in-house return was 0.03% lower than the budgeted rate of interest of 1.15%.

33. The Council operates a number of instant access call accounts and money market funds to deposit short-term cash surpluses. During 2011/12 the average balance held on instant access was £57.0m.

34. At 31 March 2012, the Council's investment portfolio of £274.85m comprised £174.53m of fixed term deposits, £75.99m at short term notice in money market funds and call accounts, £12.05 in short dated bond funds and £12.28m managed by external fund managers. Annex 4 shows the analysis of the investment portfolio at 31 March 2012.

35. The council's Treasury Management Strategy Team regularly monitors the risk profile of the Council's investment portfolio. An analysis of the credit and maturity position of the portfolio at 31/3/2012 is shown in Annex 4.

External Fund Managers

36. During the year, the Council continued to use the services of two external fund managers: Investec Asset Management Limited and Scottish Widows Investment Partnership Limited (SWIP). External funds are used by the Council to help manage investment risks by diversification of the portfolio in terms of access to a range of different counterparties and through the use of different financial instruments such as corporate bonds.

37. The performances of the external funds are reported to and monitored by the Treasury Management Strategy Team on a monthly basis. A review of the SWIP holdings found that the majority of the funds were placed in the SWIP short dated bond fund. As the Council is able to invest directly in this fund, the decision was made to end the segregated mandate with SWIP and to invest £12.0m of the balance directly in the Short dated bond fund. This transaction was completed on 30 March 2012 and has allowed the Council to save the minimum annual management fee of £20,000 for 2012/13 while maintaining the same portfolio diversification and return.

38. SWIP's annualised return for the year (1 April 2011 to 30 March 2012) was 1.32%, compared with a benchmark of 0.48%.

39. The Investec mandate was changed in December 2010 to a non-discretionary mandate where proportions of the portfolio are invested in three different types of investment fund as set out in the table below:

Fund Name	Weighting	Investment Objectives
Liquidity Fund	5%	To achieve a superior return to that of cash deposits while maintaining capital and preserving liquidity.
Short Dated Bond Fund	65%	To provide capital stability and income through investment in short term fixed income and variable rate securities listed or traded in one or more Recognised Exchanges.
Target Return Fund	30%	To produce a positive return over the longer term regardless of market conditions by investing primarily in interest bearing assets and related derivatives.

40. The month on month performance of the Target Return Fund has been volatile during 2011/12. Investec's overall return for the year (net of management charges) was 0.83%, compared with a benchmark of 1.71%. This reflects the nature of the fund and the need to view the performance over the longer term.

41. Officers are continuing to monitor the performance of the fund on a monthly basis and have regular meetings with the fund manager.

Prudential Indicators for Treasury Management

42. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Management Strategy Report. The outturn for the Prudential Indicators is shown in Annex 5.

External Performance Indicators and Statistics

43. The County Council is a member of the CIPFA Treasury and Debt Management Benchmarking Club and completed returns for the financial year 2011/12. The results of this exercise are not yet available.

44. Arlingclose has also benchmarked Oxfordshire County Council's investment performance against its other clients. Since 31 March 2011 the Council has maintained the yield on its deposits whilst simultaneously maintaining low credit risk. When compared against other County Councils, Oxfordshire County Council's deposit portfolio sits on the average line for interest rate and the lowest quartile for credit risk. The investment performance benchmarking is shown in Annex 6.

Financial and Legal Implications

45. The combined activities of debt and investment management contribute to the strategic measures element of the Council's budget. In the Medium Term Financial Plan, the budget for Interest Payable in 2011/12 was £18.808m compared with the outturn of £19.280m giving a net overspend of £0.472m.

46. The 2011/12 budget for interest receivable was £2.507m, compared with the outturn of £3.109m giving a net overachievement of £0.602m. In addition the 2011/12 accounts recognise an increase in the value of available for sale assets[2] of £0.102m. The increase in interest received is due to higher average cash balances due in part to slippage on the capital programme and receipt of government grants earlier in the year**.** This mitigated the impact of lower than forecast average interest rate**.**

47. The budget for Interest Payable in 2012/13 is £18.756m. The expected return for Interest Receivable in 2012/13 is £2.234m (in house) and £0.215m (external). These positions will be reviewed during the year.

RECOMMENDATION

48. **The Cabinet is RECOMMENDED to note the report, and to RECOMMEND Council to note the Council's Treasury Management Activity in 2011/12.**

SUE SCANE
Assistant Chief Executive and Chief Finance Officer

Contact officer: Hannah Doney

[2] Available for sale assets comprise the Investec fund and short dated bond funds.

Telephone Number: 01865 323988

June 2012

Annex 1

OXFORDSHIRE COUNTY COUNCIL DEBT FINANCING 2011/12

Debt Profile		£m
1. PWLB	88%	384.41
2. Money Market LOBO loans	11%	50.00
3. Sub-total External Debt		434.41
4. Internal Balances	1 %	3.21
5. Actual Debt at 31 March 2011	**100%**	**437.62**
6. Government Supported Borrowing		0.00
7. Unsupported Borrowing		1.35
8. Borrowing in Advance		0.00
9. Minimum Revenue Provision		-18.52
10. Actual Debt at 31 March 2012		**420.45**

Maturing Debt

11. PWLB loans maturing during the year	13.69
12. PWLB loans repaid prematurely in the course of debt restructuring	0.00
13. Total Maturing Debt	**13.69**

New External Borrowing

14. PWLB Normal	0.00
15. PWLB loans raised in the course of debt restructuring	0.00
16. Money Market LOBO loans	0.00
17. Total New External Borrowing	**0.00**

Debt Profile Year End

18. PWLB	88%	370.72
19. Money Market LOBO loans	12%	50.00
20. Sub-total External Debt		420.72
21. Internal Balances	- 0 %	-0.27
22. Actual Debt at 31 March 2012	**100%**	**420.45**

Line

1 – 5 This is a breakdown of the Council's debt at the beginning of the financial year (1 April 2011). The PWLB is a government agency operating within the Debt Management Office. LOBO (Lender's Option/ Borrower's Option) loans are long-term loans, with a maturity of up to 60 years, which includes a re-pricing option for the bank at predetermined time intervals. Internal balances include provisions, reserves, revenue balances, capital receipts unapplied, and excess of creditors over debtors.

6 'Government Supported Borrowing' is the amount that the Council can borrow in any one year to finance the capital programme. This is determined by Central Government, and in theory supported through the Revenue Support Grant (RSG) system.

7 'Unsupported Borrowing' reflects Prudential Borrowing taken by the authority whereby the associated borrowing costs are met by savings in the revenue budget.

8 'Borrowing in Advance' is the amount the Council borrowed in advance during 2011/12 to fund future capital finance costs.

9 The amount of debt to be repaid from revenue. The sum to be repaid annually is laid down in the Local Government and Housing Act 1989, which stipulates that the repayments must equate to at least 4% of the debt outstanding at 1 April each year.

10 The Council's total debt by the end of the financial year at 31 March 2012, after taking into account new borrowing, debt repayment and movement in funding by internal balances.

11 The Council's normal maturing PWLB debt.

12 PWLB debt repaid early during the year.

13 Total debt repaid during the year.

14 The normal PWLB borrowing undertaken by the Council during 2011/12

15 New PWLB loans to replace debt repaid early.

16 The Money Market borrowing undertaken by the Council during 2011/12.

17 The total external borrowing undertaken.

18-22 The Council's debt profile at the end of the year.

Annex 2

Long-term debt Maturing 2011/12

Public Works Loan Board: Loans Maturing in 2011/12

Date	Amount £m	Rate %	Repayment Type
01/04/2011	5.000	9.500	Maturity
22/05/2011	3.000	9.000	Maturity
13/07/2011	0.500	2.350	EIP
31/07/2011	0.500	2.350	EIP
31/08/2011	0.342	1.120	Annuity
16/09/2011	1.000	9.500	Maturity
01/12/2011	2.000	7.500	Maturity
13/01/2012	0.500	2.350	EIP
31/01/2012	0.500	2.350	EIP
28/02/2012	0.344	1.120	Annuity
Total	**13.686**		

Repayment Types

Maturity – Full amount of principal is repaid at the final maturity date
EIP – Equal Instalments of Principal are repaid every 6 months until the final maturity date
Annuity – A reducing balance of principal is repaid every 6 months until the final maturity date

Annex 3

Lending List Changes during 2011/12

Counterparties added during 2011/12

Legal and General Sterling Liquidity Fund

SWIP Global Liquidity Fund

Counterparties removed during 2011/12

Bank of New York Mellon

Bank of Scotland

Clydesdale Bank

Crown Agents Bank

BNP Paribas

Credit Industriel et Commercial (CIC)

DnB NOR Bank

Nordea Bank Finland

Rabobank Group

Santander UK Plc

Svenska Handelsbanken

Counterparties suspended and reinstated during 2011/12

Lloyds TSB

Nationwide Building Society

Prime Rate Sterling Fund

Royal Bank of Scotland

Santander UK Plc

Lending limits & Maturity limits decreased from 1 April 2011

	Lending Limit as at 31 March 2012	Maximum Maturity as at 31 March 2012
Santander UK plc	£5,000,000	O/N
Royal Bank of Scotland	£10,000,000	3 months
Lloyds TSB Bank plc	£10,000,000	3 months
Bank of Montreal	£25,000,000	6 months
Bank of Nova Scotia	£25,000,000	6 months
Barclays Bank	£15,000,000	3 months
Canadian Imperial Bank of Commerce	£25,000,000	6 months
Commonwealth Bank of Australia	£25,000,000	6 months
HSBC Bank	£25,000,000	6 months
JP Morgan Chase Bank	£25,000,000	3 months
National Australia Bank	£25,000,000	6 months
National Bank of Canada	£10,000,000	6 months
Nationwide Building Society	£15,000,000	3 months
Royal Bank of Canada	£25,000,000	6 months
Prime Rate Sterling Fund	£9,000,000	6 months
Standard Chartered Bank	£25,000,000	3 months
Toronto-Dominion Bank	£25,000,000	6 months

Annex 4

OXFORDSHIRE COUNTY COUNCIL INVESTMENT PORTFOLIO 31/03/2012

Fixed term deposits held at 31/03/2012

Counterparty	Principal Deposited (£)	Maturity Date
Landsbanki Islands HF	1,410,738	29-Mar-13
Landsbanki Islands HF	2,117,965	29-Mar-13
Newcastle City Council	5,000,000	5-Jul-12
Newcastle City Council	5,000,000	2-Jul-12
Shepway District Council	2,000,000	29-Jun-12
Shepway District Council	2,000,000	28-Jun-13
Doncaster Metropolitan Borough Council	3,000,000	2-Apr-12
HSBC Bank plc	10,000,000	27-May-14
Newcastle City Council	5,000,000	31-Dec-12
Barclays Bank Plc (Direct)	4,000,000	15-May-12
Commonwealth Bank of Australia	5,000,000	15-Jun-12
Northumberland County Council	5,000,000	28-Mar-13
Northumberland County Council	5,000,000	16-Sep-13
Cambridgeshire County Council	5,000,000	28-Sep-12
Cambridgeshire County Council	5,000,000	29-Jun-12
Rabobank Group (Direct)	5,000,000	5-Apr-12
National Australia Bank (Direct)	5,000,000	27-Apr-12
Kingston Upon Hull City Council	6,000,000	15-May-14
Kingston Upon Hull City Council	1,000,000	31-Oct-13
Bank of Nova Scotia	10,000,000	17-May-12
Fife Council	9,000,000	20-Dec-13
Fife Council	5,000,000	28-Jun-13
Fife Council	5,000,000	15-Aug-14
Corby Borough Council	7,000,000	17-Dec-12
Fife Council	4,000,000	31-Oct-13
Glasgow City Council	3,000,000	15-Jan-13
Bassetlaw District Council	3,000,000	11-Jan-13
Doncaster Metropolitan Borough Council	5,000,000	25-Apr-14
Lloyds TSB Bank plc	1,000,000	2-May-12
Cheshire West and Chester Council	5,000,000	20-Feb-13
Lloyds TSB Bank plc	2,000,000	1-Jun-12
Mid Suffolk District Council	5,000,000	5-Mar-13
Commonwealth Bank of Australia	5,000,000	7-Jun-12
The Mayor’s Office for Policing and Crime	10,000,000	13-Mar-15
Kettering Borough Council	4,000,000	15-Mar-13
Total	**154,528,703**	

Structured deposits held at 31/3/2012

Counterparty	Principal Deposited (£)	Maturity Date
Barclays Bank PLC (Through Broker)	5,000,000	20Jul-12
HSBC Bank plc	5,000,000	28-Mar-13
HSBC Bank plc	10,000,000	27-May-14

	Total	20,000,000

Short-term notice call accounts and Money Market Funds

Counterparty	Balance at 31/03/12 (£)	Notice period
Royal Bank of Scotland Call Account	5,003,909	Same day
Santander UK Call Account	5,002,521	Same day
Goldman Sachs MMF	129	Same day
Deutsche Global Liquidity Fund	6,980,900	Same day
Prime Rate Sterling Liquidity Fund	9,006,185	Same day
Ignis	25,000,000	Same day
Legal and General Sterling Liquidity Fund	25,000,000	Same day
Total	**75,993,644**	

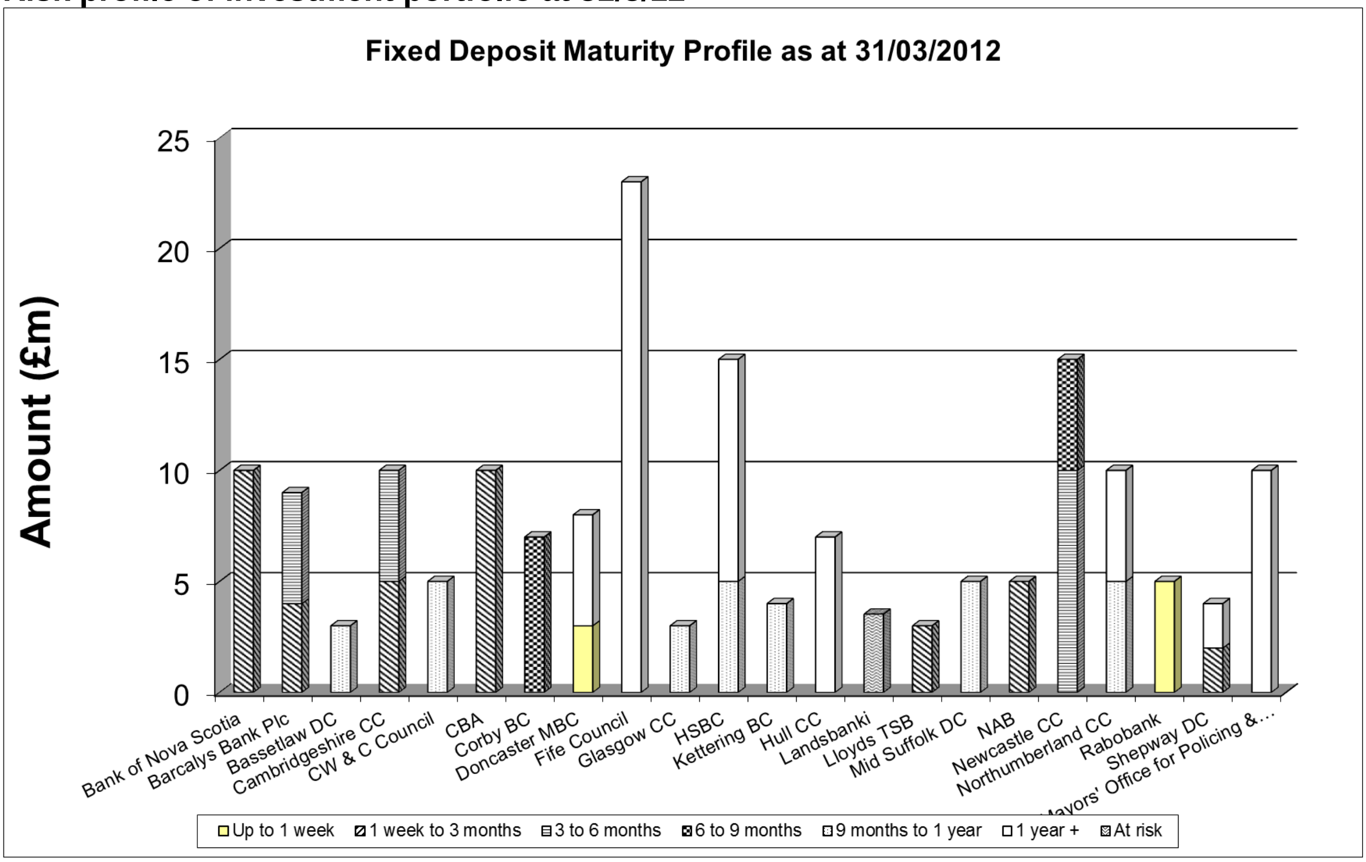
Short Dated Bond Funds

Counterparty	Balance at 31/03/12 (£)	Notice period
SWIP	12,000,513	2 days
Prime Rate Cash Plus Fund	50,295	2 days
Total	**12,050,808**	

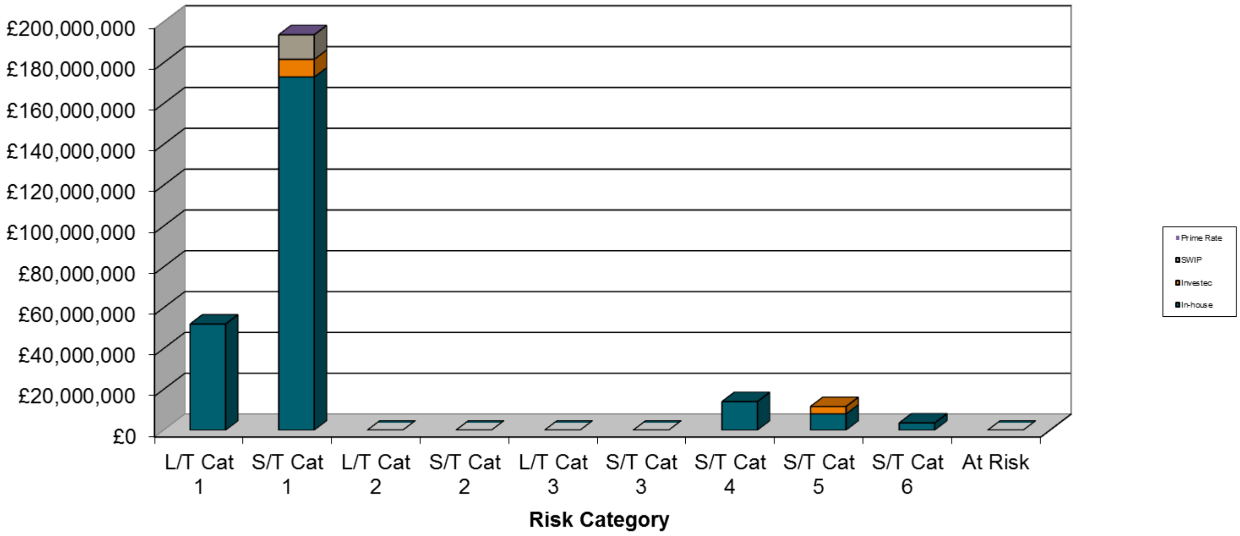
Externally Managed Funds

Fund Manager	Value of Fund at 31/03/12 (£)
Investec	12,278,350
Total	**12,278,350**

Risk profile of investment portfolio at 31/3/12

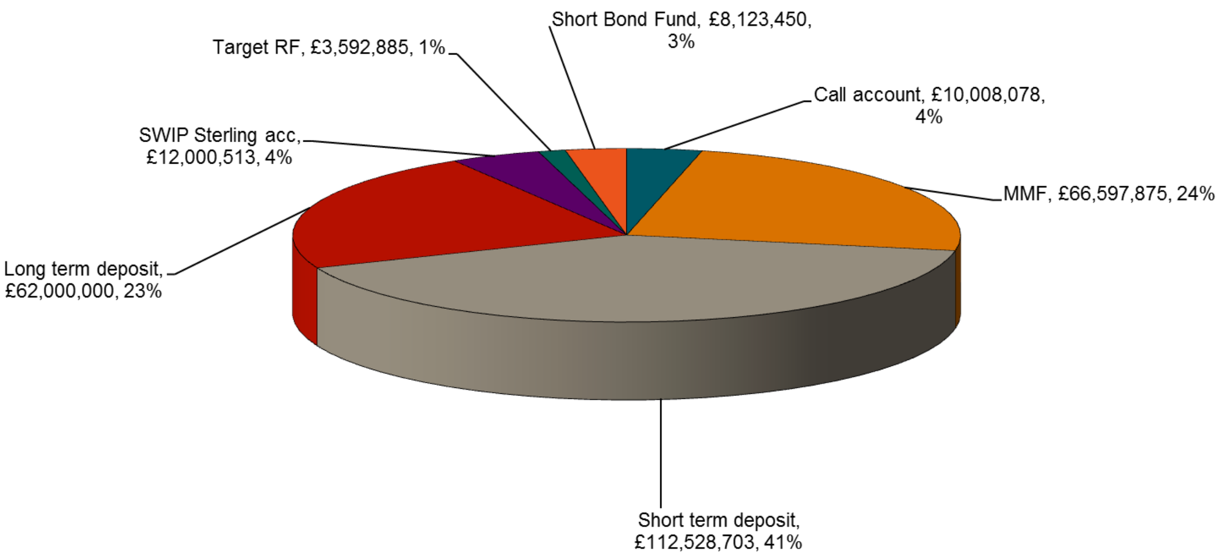


Risk Profile - Total Combined Portfolio as at 31.03.2012



Risk Category	L/T rating	S/T rating	Individual rating	Viability rating
1	AA+, AA	F1+	1, 2	aaa, aa
2	AA-	F1+	1, 2	aa, a
3	AA-	F1+	1	bbb
4	AA-	F1+	1	bbb
5	A+, A	F1	1, 2, 3	a, bbb,bb
6	A	F1	2, 3, lower	b or lower

Total Combined Portfolio as at 31.03.2012



Annex 5

Prudential Indicators Outturn 31 March 2012

Authorised and Operational Limit for External Debt

Authorised Limit for External Debt	£486,000,000
Operational Limit for External Debt	£476,000,000
Actual External Debt at 31 March 2012	£420,728,448

Fixed Interest Rate Exposure

Fixed Interest Net Borrowing limit	150.00%
Actual at 31 March 2012	139.04%

Variable Interest Rate Exposure

Variable Interest Net Borrowing limit	25.00%
Actual at 31 March 2012	- 39.04%

Sums Invested over 365 days

Total sums invested for more than 364 days maximum limit	£100,000,000
Actual sums invested for more than 364 days at 31 March 2012	£ 67,000,000

Maturity Structure of Borrowing at 31/03/12

	Limit %	**Actual %**
From 01/04/11		
Under 12 months	0 - 20	0
12 – 24 months	0 - 25	7.93
24 months – 5 years	0 - 35	9.27
5 years – 10 years	5 - 40	14.97
10 years +	50 - 95	67.83

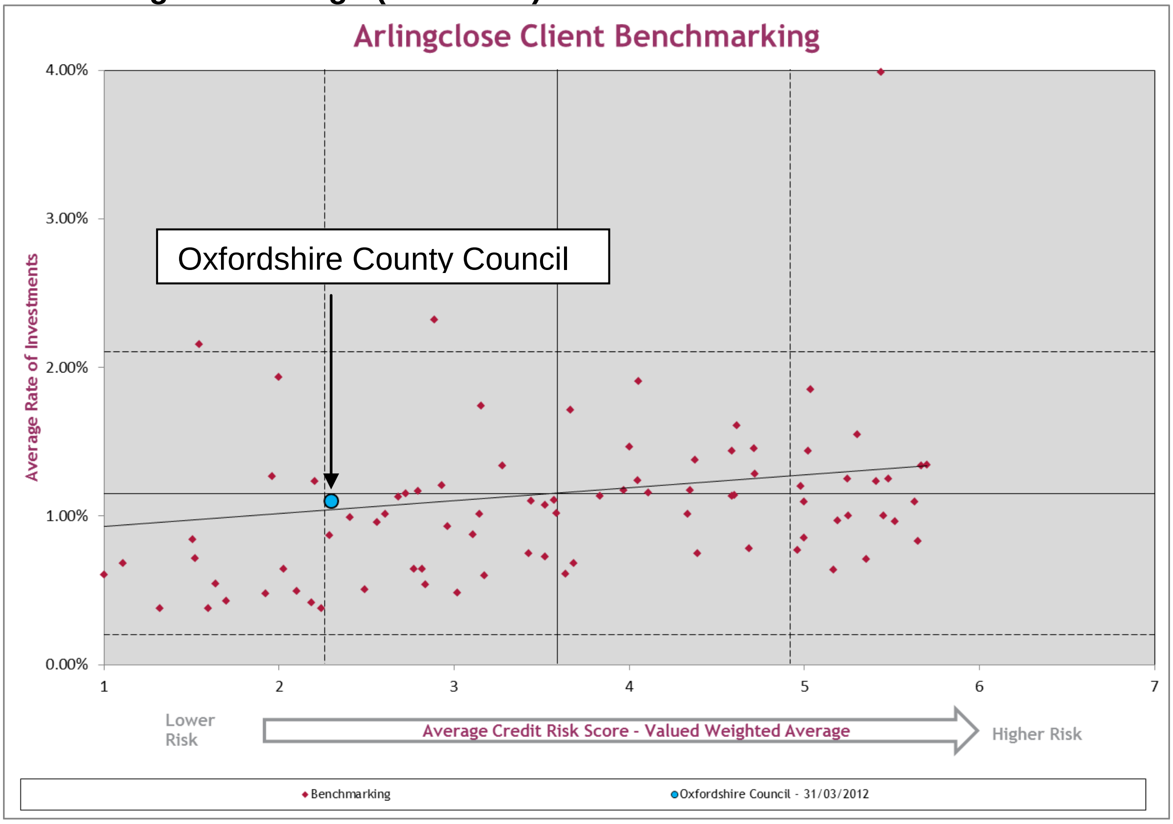
The Prudential indictors for Maturity structure are set with reference to the start of the financial year. The actual % shown above relates to the maturity period remaining at 01/04/11 on loans still outstanding at 31/03/12.

Actual Maturity Structure of Borrowing at 01/04/12

	Limit %	**Actual %**
From 01/04/12		
Under 12 months	0 - 20	6.74
12 – 24 months	0 - 25	3.80
24 months – 5 years	0 - 35	8.56
5 years to 10 years	5 – 40	18.30
10 years +	50 – 95	62.60

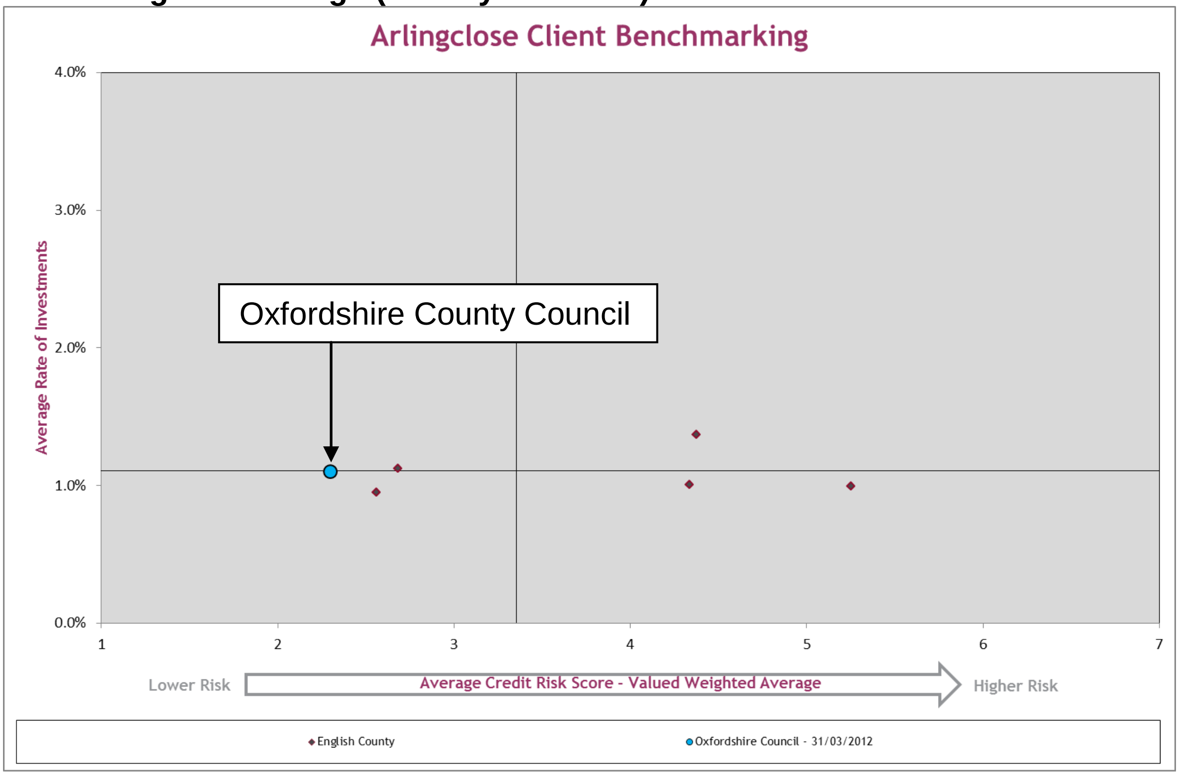
Annex 6

Value weighted average (all clients)



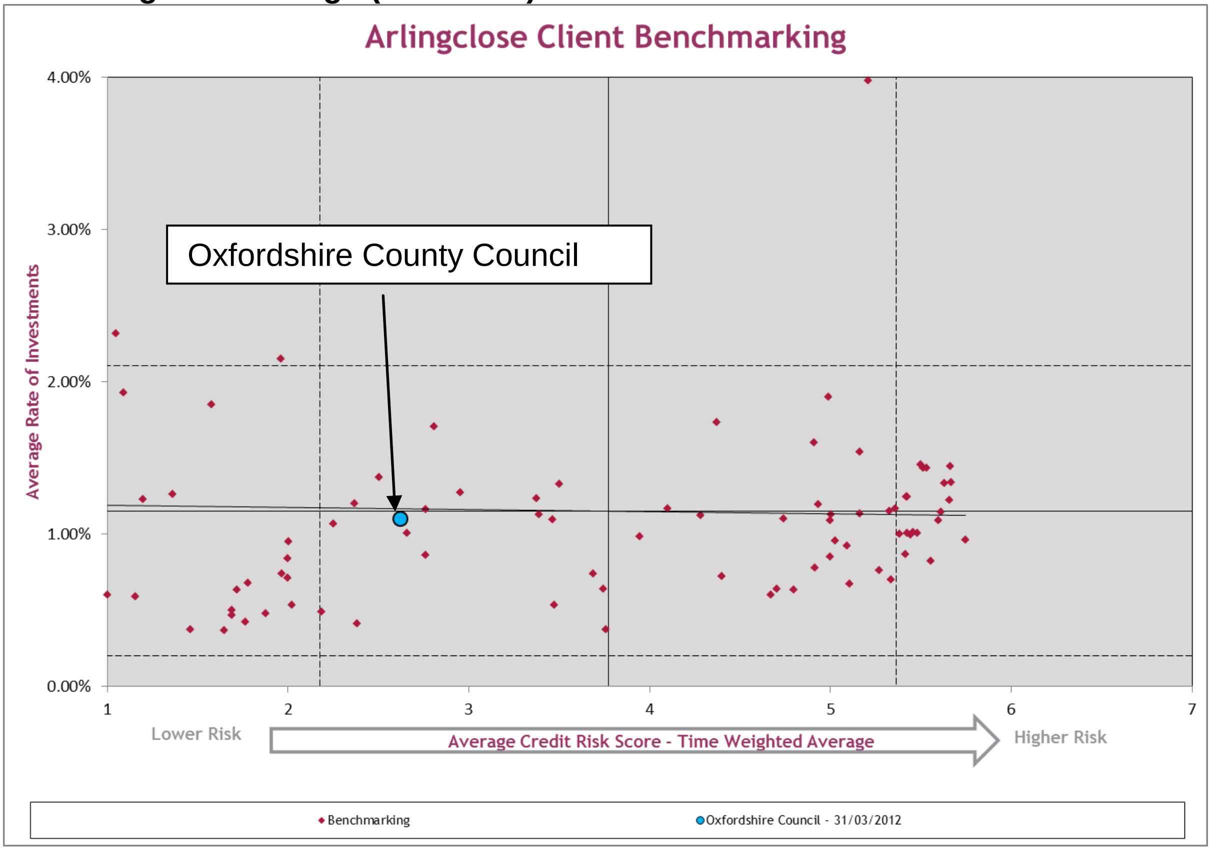
The above graph shows that Oxfordshire County Council achieved the average interest rate for the credit weighting of all clients of Arlingclose as at 31/03/2012.

Value weighted average (County Councils)



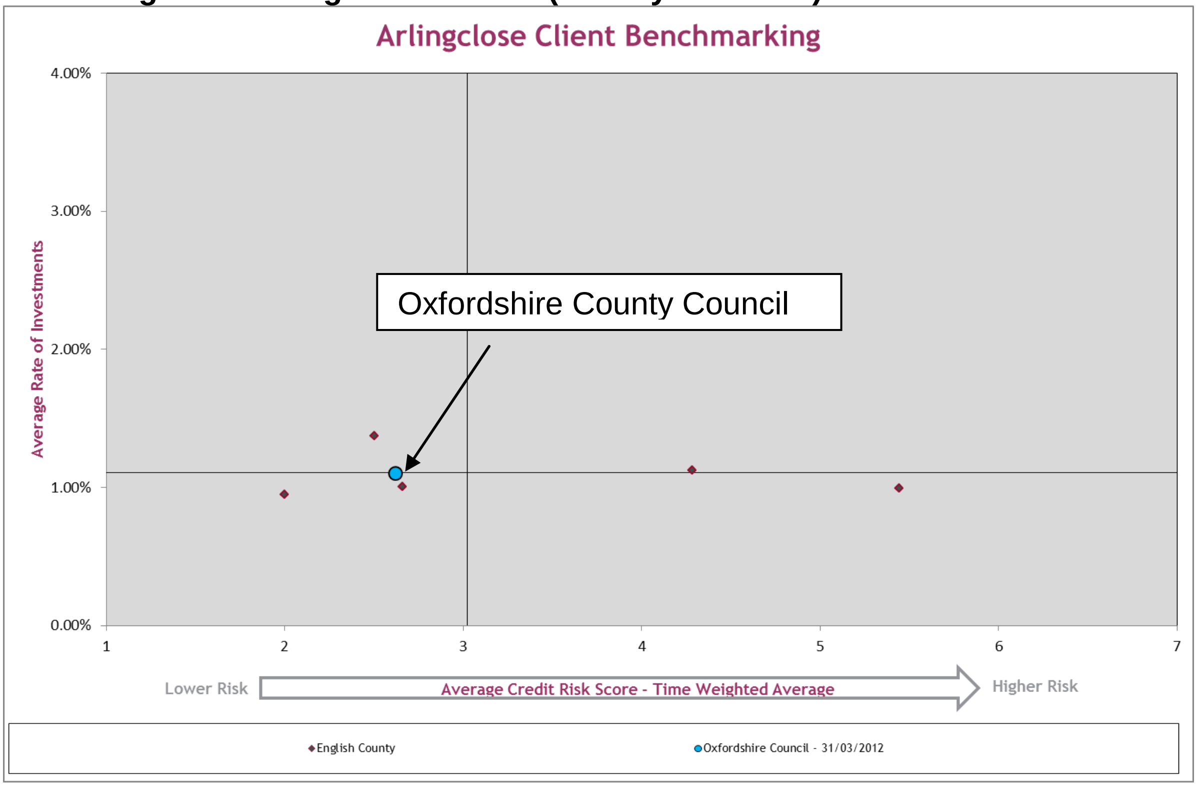
The above graph shows that Oxfordshire County Council achieved a similar interest rate for less credit risk compared to 5 other County Councils as at 31/03/2012.

Time weighted Average (all clients)



The above graph shows that Oxfordshire County Council achieved a near average interest rate on deposits whilst maintaining a relatively low credit risk at 31/03/2012.

Time weighted Average Credit Risk (County Councils)



The above graph shows that Oxfordshire County Council achieved a similar interest rate to the other County Councils in the sample, whilst it maintained a significantly lower time weighted credit risk as at 31/03/2012.