

CABINET – 15 NOVEMBER 2011

TREASURY MANAGEMENT MID TERM REVIEW 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' recommends that members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.
2. The following annexes are attached:
 - Annex 1 Lending List Changes
 - Annex 2 Debt Financing 2011/12
 - Annex 3 PWLB debt Raised and Maturing
 - Annex 4 Prudential Indicator Update.

Strategy 2011/12

3. The approved Treasury Management Strategy for 2011/12 was based on an average *base rate forecast of 0.75%*.
4. The Strategy for Long Term Borrowing was to use internal balances only.
5. The Strategy included the continued use of the services of external fund managers, Scottish Widows Investment Partnership (SWIP) and Investec.

Economic Background

6. **Growth:** Global growth prospects deteriorated considerably over the six months to September, moving from an expectation of modest expansion to the risk of a double-dip recession. Q1 2011 GDP in the UK was 0.5%, but was just 0.2% in Q2. Even economies like Germany's, which were hitherto seemingly strong, began to flounder with growth registering 0.1% in Q2.
7. **Inflation:** Inflation remained stubbornly high. Annual CPI for September 2011 was 5.2%; CPI has remained above the MPC's 3% upper limit now for 21 consecutive months and required the Bank of England's Governor to write his seventh open letter to the Chancellor. The Bank believes the elevated rate of inflation reflects the temporary impact of several factors including, the increase in the VAT rate to 20%, past increases in global energy prices and import prices. The expectation is that in early 2012, the year on year impact of these factors will fall out and inflation will start to lower.

8. The Bank of England's August Inflation Report downgraded the growth forecast even as it acknowledged energy price rises could push CPI to 5% before inflation fell back to the 2% target over the medium-term. The UK's strategy of combining loose monetary policy (the Bank Rate had remained at 0.5% for 2½ years and Quantitative Easing at £200bn) with tight fiscal policy supported the rebalancing of the economy and also commanded support in the markets.
9. In the US, the country's weak economic and fiscal situation and an unemployment rate of 9.1% left the Federal Reserve little option but to commit to "exceptionally low" interest rates until mid 2013.
10. The European sovereign debt crisis has deepened. The agreement in July 2011 to address Greece's fiscal problems and broaden the mandate for the European Financial Stability Facility (EFSF) only bought time for the Eurozone as market pressure increased on Italy and Spain, but did little to address the issue of overburdened sovereign balance sheets. The further EU bailout plan agreed in late October 2011, comprising a 100bn euro loan and 50% debt write off in return for deep cuts in public spending now hangs in the balance following the announcement by the Greek Prime Minister of a referendum on the deal.
11. The European Banking Authority (EBA) released the results of the second of its stress tests in July. 8 banks (two Greek, one Austrian and five small domestic Spanish banks) out of 91 banks failed the tests. All of the UK and non-UK banks tested by the EBA and which are on the Council's lending list met the 'stressed' Core Tier 1 Ratio of 5%, none were adjudged as 'near-failed' (i.e. having ratios between 5% and 6%).
12. **Gilt yields and money market rates:** The economic uncertainty resulted in analysts postponing the likelihood of an increase in the UK Bank Rate until mid 2012. Gilts were considered a safe haven and benefited from market turmoil. Gilt yields fell to their lowest levels in five years. 5-year gilt yields fell to 1.25%, 10-year yields to 2.2% and 20-year yields to 3.05%.

Treasury Management Activity

Debt Financing

13. Oxfordshire County Council's (the Council) debt financing to date for 2011/12 is analysed in Annex 2.
14. The 2011/12 borrowing strategy is to use internal balances where necessary to refinance maturing debt. This is intended to reduce the cost of carry (the difference between borrowing rates and investment returns) and reduce counterparty risk by minimising the level of cash balances.
15. There has been no change to this strategy.
16. The Council's cumulative total external debt has decreased from £434.41m on 1 April 2011 to £424.07m by 30 September 2011, a net decrease of £10.34m. No new debt

has been arranged during the year. The total forecast external debt for 31 March 2012, after repayment of loans maturing during the year is £420.74m. The forecast debt financing position for 31 March 2012, is shown in Annex 2.

17. At 30 September 2011, the authority had 72 PWLB¹ loans totalling £374.07m and 10 LOBO² loans totalling £50m. The combined weighted average interest rate for debt as at 30th September 2011 was 4.52%.

Maturing Debt

18. The Council repaid £10.34m of maturing PWLB loans during the first half of the year. The details are set out in Annex 3.

Debt Restructuring

19. There has been no restructuring of Long Term Debt during the year.

Investment Strategy

20. Security and liquidity of cash was prioritised above the requirement to maximise returns. The Council continued to adopt a cautious approach to lending to financial institutions and continuously monitored credit quality information relating to counterparties.
21. A mixture of short term, (up to 12 months), and longer term, (greater than 12 months), deposits have been arranged throughout the first half of the financial year. An emphasis has been placed on lending to high credit quality banks and other Local Authorities.
22. The continued European bank turmoil and recent credit rating downgrades of UK banks has reduced the number of counterparties and the limits on the approved Treasury Management Lending List. A policy of lending longer term to other Local Authorities has limited the impact of this.
23. The Council used fixed and structured deposits, as well as call accounts and Money Market Funds to deposit its in-house temporary cash surpluses during the first half of 2011/12.

The Council's Lending List

24. 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 to reflect changes in bank and building society credit ratings. Changes are reported to Cabinet each month. Annex 1 shows the amendments incorporated into the

¹ PWLB (Public Works Loans Board) is a Government agency operating within the United Kingdom Debt Management Office and is responsible for lending money to Local Authorities.

² LOBO (Lender's Option/Borrower's Option) Loans are long-term loans which include a re-pricing option for the bank at predetermined intervals.

Lending List during the first half of 2011/12, in accordance with the approved credit rating criteria and additional temporary restrictions.

25. During May 2011, a maturity limit was breached when a 3 year loan was arranged one week in advance of the loan start date. The forward period was not taken into account when the maturity date was fixed. The maturity limit was consequently breached by one week. Also during May a 5 month loan was arranged with a counterparty which, at the time of the deal was subject to a temporary maturity limit reduction from 3 years to 1 month, due to uncertainty about the strength of the Sovereign. However, the restriction was lifted shortly afterwards, during a lending list review. There has been no financial loss to the Council as a result of the breaches of the temporary lending restrictions.

Investment Outturn

26. The average daily balance of temporary surplus cash invested in-house in the six months to 30th September was £257m. The Council achieved an average in-house return for that period of 1.11%, producing gross interest receivable of £1.429million (excluding interest accrued on Landsbanki deposits). Temporary surplus cash includes; developer contributions; school balances; 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 earned on all balances.
27. The Council uses the three month inter-bank sterling bid rate as its benchmark to measure its own in-house investment performance. During the first half of 2011/12 the average seven-day interbank sterling rate was 0.72%. The Council's average in-house return (1.11%) thus exceeded the benchmark by 0.39%. The Council operates a number of call accounts and instant access Money Market Funds to deposit short-term cash surpluses. The average balance held on call in the 6 months to 30 September was £56.7million.

Icelandic deposits

28. On Friday 28th October, the council received notification that the Icelandic Supreme Court had upheld the decision to apply priority creditor status to the local authority test cases. However, as Oxfordshire County Council was not one of the test cases, the authority awaits confirmation from the winding up board of Landsbanki stating how they will apply the Supreme Court decision to the non-test cases and their intended next steps.

External Fund Managers

29. The Council has continued to use the services of two external fund managers: Investec Asset Management Limited and Scottish Widows Investment Partnership Limited (SWIP). Each fund manager manages £10m of the Council's cash, plus their accumulated returns. Investec began managing the fund on 13 April 2006 and SWIP on 13 July 2006. The fund managers were given slightly different investment targets and performance is measured against different benchmarks.

30. SWIP's annualised return for the first 6 months of the year was 1.05% (net of management charges); compared to their annualised benchmark of 0.48%. Investec's annualised return net of management charges for the first 6 months of the year was 0.075%, compared with a benchmark of 1.48%.

Prudential Indicators for Treasury Management

31. 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 4.

External Performance Indicators and Statistics

32. The County Council is a member of the CIPFA Treasury and Debt Management benchmarking club and receives annual reports comparing returns and interest payable against other authorities. The benchmarking results for 2010/11 showed that Oxfordshire County Council had achieved an average return of 0.9% compared with an average of 1.1% for their comparative group of County Councils and an average of 1.2% for all 96 members. The lower average interest received was mainly due to higher than average balances in short-term deposits and lower balances in longer-term and structured products.
33. The average interest rate paid for all debt during 2010/11 was 4.3% compared with the comparative group of County Councils' average of 4.7%. Oxfordshire County Council had 88% of its debt portfolio in PWLB loans compared with a County Council member average of 84%

Training

34. As stated in the Treasury Management Strategy, key Treasury Management officers will be encouraged to study towards the new CIPFA and ACT³ joint Certificate on International Treasury Management – Public Finance. Two of the current dealers have the qualification and the newly appointed members of the treasury management team will be encouraged to study for the examinations as early as is practical.
35. On 17 October 2011 members and officers were invited to attend a half day training seminar on Treasury Management and Debt which had been prepared by the Treasury Management and Capital Financing teams. Arlingclose, the Council's Treasury Management advisors, presented some of the training sessions.

Financial and Legal Implications

36. Interest payable and receivable in relation to Treasury Management activities are only two parts of the overall Strategic Measures budget.

³ Association of Corporate Treasurers

37. The 2011/12 budget for interest receivable is £2.519m. The forecast outturn for interest receivable is £2.715m giving net forecast excess income of £0.196m. The increase is mainly due to higher average cash balances due in part to changes to grant funding which has resulted in the receipt of grant income being weighted more to the first half of the financial year. This has offset lower than expected interest rates.
38. The 2011/12 budget for interest payable is £18.808m. The forecast outturn for interest payable is £19.274m giving a net forecast overspend of £0.466m. The increase is due to no LOBO loans being repaid this year.

RECOMMENDATION

39. **The Cabinet is RECOMMENDED to note the report, and to RECOMMEND Council to note the Council's Mid Term Treasury Management Review 2011/12.**

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October 2011

Lending List Changes during 2011/12**Counterparties added/reinstated**

Svenska Handelsbanken

Counterparties removed/suspended

Clydesdale Bank Plc
 Crown Agents Bank
 BNP Paribas
 Credit Industriel et Commercial

Lending limits & Maturity limits decreased

| Maturity | New Lending limit | Maximum |
|--|--------------------------|----------------|
| Royal Bank of Scotland Plc | £5m | Overnight |
| Santander UK Plc | £5m | 3 months |
| Lloyds TSB Bank Plc | £5m | 3 months |
| Bank of Scotland Plc | £5m | 3 months |
| Nationwide Building Society | £5m | 3 months |
| Barclays Bank Plc | £15m | 6 months |
| HSBC Bank Plc | £20m | 6 months |
| Standard Chartered Bank | £20m | 6 months |
| DnB Nor Bank | £10m | 1 month |
| Nordea Bank Finland | £20m | 1 month |
| Svenska Handelsbanken | £20m | 6 months |
| Rabobank Group | £25m | 6 months |
| All American, Canadian & Australian Counterparties | Unchanged | 6 months |
| All other Counterparties (excl. other Local Authorities) | Unchanged | 6 months |

OXFORDSHIRE COUNTY COUNCIL DEBT FINANCING 2011/12

| <u>Debt Profile</u> | | £m |
|---|-------------|---------------|
| 1. PWLB | 88% | 384.41 |
| 2. Money Market LOBO loans | 11% | <u>50.00</u> |
| 3. Sub-total External Debt | | 434.41 |
| 4. Internal Balances | 1% | <u>3.21</u> |
| 5. Actual Debt at 31 March 2011 | 100% | 437.62 |
| 6. Government Supported Borrowing | | 0.00 |
| 7. Unsupported Borrowing | | 8.92 |
| 8. Borrowing in Advance | | 0.00 |
| 9. Minimum Revenue Provision | | <u>-20.18</u> |
| 10. Forecast Debt at 31 March 2012 | | 426.36 |
| <u>Maturing Debt</u> | | |
| 11. PWLB loans maturing during the year | | -13.67 |
| 12. PWLB loans repaid prematurely in the course of debt restructuring | | <u>0.00</u> |
| 13. Total Maturing Debt | | -13.67 |
| <u>New External Borrowing</u> | | |
| 14. PWLB Normal | | 0.00 |
| 15. PWLB loans raised in the course of debt restructuring | | 0.00 |
| 16. Money Market LOBO loans | | <u>0.00</u> |
| 17. Total New External Borrowing | | 0.00 |
| <u>Debt Profile Year End</u> | | |
| 18. PWLB | 86% | 370.74 |
| 19. Money Market LOBO loans | 11% | <u>50.00</u> |
| 20. Sub-total External Debt | | 420.74 |
| 21. Internal Balances | 3% | <u>5.62</u> |
| 22. Forecast Debt at 31 March 2012 | 100% | 426.36 |

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 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 forecast total debt by the end of the financial year, 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 repayable 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 forecast debt profile at the end of the year.

Long-Term Debt Maturing 2011/12**Public Works Loan Board: Loans Matured during first half of 2011/12**

| Date | Amount £m | Rate % |
|--------------|------------------|---------------|
| 01/04/2011 | 5.000 | 9.50 |
| 22/05/2011 | 3.000 | 9.00 |
| 13/07/2011 | 0.500 | 2.35 |
| 31/07/2011 | 0.500 | 2.35 |
| 31/08/2011 | 0.342 | 1.12 |
| 16/09/2011 | 1.000 | 9.50 |
| Total | 10.342 | |

Public Works Loan Board: Loans Due to Mature during second half of 2010/11

| Date | Amount £m | Rate % |
|--------------|------------------|---------------|
| 01/12/2011 | 2.000 | 7.50 |
| 13/01/2012 | 0.500 | 2.35 |
| 31/01/2012 | 0.500 | 2.35 |
| 28/02/2012 | 0.344 | 1.12 |
| Total | 3.344 | |

Prudential Indicators Position 30th September 2011**Authorised and Operational Limit for External Debt**

| External Debt | Operational Limit £m | Authorised Limit £m | Actual 30/09/11 £m | Forecast 31/03/12 £m |
|-----------------------------|-----------------------------|----------------------------|---------------------------|-----------------------------|
| Borrowing | 543 | 553 | 424 | 421 |
| Other Long-Term Liabilities | 40 | 40 | 6 | 6 |
| TOTAL External Debt | 583 | 593 | 430 | 427 |

Capital Financing Requirement for year £429,164,000

Fixed Interest Rate Exposure

Fixed Interest Net Borrowing limit 150%
Actual at 30 September 2011 113%

Variable Interest Rate Exposure

Variable Interest Net Borrowing limit 25%
Actual at 30 September 2011 -13%

Sums Invested over 365 days

Total sums invested for more than 364 days limit £100,000,000
Actual sums invested for more than 364 days £ 37,000,000

Maturity Structure of Borrowing

| | Limit % | Actual % |
|---------------------|----------------|-----------------|
| Under 12 months | 0 - 20 | 4.31 |
| 12 – 24 months | 0 - 25 | 4.33 |
| 24 months – 5 years | 0 - 35 | 9.20 |
| 5 years to 10 years | 5 - 40 | 14.86 |
| 10 years + | 50 - 95 | 67.30 |