PLYMOUTH CITY COUNCIL

Subject:	Annual Report on Treasury Management Activities for 2011/12
Committee:	Audit Committee
Date:	21 June 2012
Cabinet Member:	Councillor Lowry
CMT Member:	Director for Corporate Services
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Ref:	Acct/AL
Key Decision	No
Part:	I

Executive Summary:

In order to comply with the Code of Practice for Treasury Management, the Council is required to formally report on its Treasury Management activities for the year, providing information on the progress and outcomes against the Treasury Management Strategy. This report covers the treasury management activities for financial year 2011/12 including the final position on the statutory Prudential Indicators.

The Council's external loans at 31March 2012 stood at £206.398m. The borrowing strategy for the year was to reduce the Council's underlying level of its long-term debt meeting any borrowing requirement with short-term loans (less than 1 year) or the use of internal resources. However due to the movement in interest rates and gilts which made early repayment of debt expensive in terms of premature redemption penalties, long-term borrowing has remained unchanged at £191.398m. Total loans have reduced by £79.985m with the reduction of short-term borrowing as credit condition worsened in the second half of the year.

The reduction in short-term loans has also led to a reduction in investments at year end of £81.872m, leaving total investments of £83.975m including £21.49m invested on behalf of the Heart of the South West LEP in respect of the Growing Places Fund. Of the overall amount £46.92m was invested in instant access call accounts and could be withdrawn without penalty should circumstances require.

In terms of the impact against the revenue budget, an overall favorable variance of (£0.388m) was achieved in the year. This is mainly as a result of savings in the MRP charge to revenue and additional interest income achieved from using short-term loans as an alternative to the use of internal balances to cover capital financing requirements.

In line with the recommendations in the Code of Practice, this report is submitted to Audit Committee as the Committee responsible for scrutiny of the Treasury Management function.
This report is required to be submitted to Full Council.

Corporate Plan 2011-2014:

Treasury Management activity has a significant impact on the Council's activity both in revenue budget terms and capital investment and is a key factor in facilitating the delivery against a number of corporate priorities.

Implications for Medium Term Financial Plan and Resource Implications: Including finance, human, IT and land

Into the medium and longer term the Council is facing significant pressures due to the national economic situation, which has led to a reduction in resources for local authorities over the Government's latest spending period. Effective treasury management will be essential in ensuring the Council's cash flows are used to effectively support the challenges ahead.

Other Implications: e.g. Child Poverty, Section 17 Community Safety, Health and Safety, Risk Management, Equalities Impact Assessment, etc.

There is an inherent risk to any Treasury Management activity. The Council continues to manage this risk by ensuring all investments are undertaken in accordance with the approved investment strategy, and keeping the Counter party list under constant review.

Recommendations & Reasons for recommended action:

1. Audit Committee note the Treasury Management annual report for 2011/12.

2. The report be referred to Full Council as required by the CIPFA Treasury Management Code of Practice (TMP note 6).

3. Audit Committee approve the Treasury Management Practices for 2012-13 as outlined at Appendix 3.

Alternative options considered and reasons for recommended action:

None- requirement to report to Council on the Treasury Management activities for the year.

Background papers:

- Treasury Management Strategy report to Audit Committee 21 January 2011
- 2011/12 Budget Papers – presented to Full Council 28 February 2011
- Mid Year Review report to Audit Committee 16 December 2011
- Joint Finance and Performance report for 2010/11 to Cabinet 12 June 2012

Sign off:

Fin	DJN121 3.009	Leg/ Dem& Gov	TH0048	HR	n/a	Corp Prop	n/a	IT	n/a	Strat Proc	n/a
Originating SMT Member: Malcolm Coe											

Annual Report on Treasury Management Activities for 2011/12

1. Introduction

1.1 Treasury Management in Local Government is underpinned by the CIPFA Code of Practice on Treasury Management in the Public Services (The Code) and in this context is the "*the management of the Council's investments and cash flows, its banking, money market and its capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks*".

1.2 The Treasury Management Code requires public sector authorities to determine an annual Treasury Management Strategy, and as a minimum, formally report on their treasury activities and arrangements to Full Council at least twice a year- mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities and enable those with ultimate responsibility/governance of the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.

1.3 This report outlines the Treasury Management activities in 2011/12, providing information on progress and outcomes against the approved strategy, and builds on the mid year report presented to Audit Committee and Full Council in December 2011.

1.4 The responsibility for implementing and monitoring Treasury Management polices and practices and for the execution and administration of Treasury Management decisions is delegated by the Council to its Section 151 Officer – the Director for Corporate Services, and in 2011-12 was overseen by a Treasury Management Board consisting of senior officers within Finance, Efficiencies, Technology and Assets and the portfolio Member for Finance, Property and People.

1.5 The day to day operation of the treasury management activity is carried out in accordance with detailed Treasury Management Practices (TMP's). These are required to be updated annually. The TMP's applicable to 2011/12 were approved by Audit Committee at its meeting of 27 June 2011.

1.6 The Council works closely with its treasury management advisors Arlingclose who assist the Council in formulating views on interest rates when determining the Treasury Management Strategy, regular updates on economic conditions and interest rate expectations, and advice on specific borrowing and investment decisions.

1.7 This report:

a) is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code;
b) presents details of capital financing, borrowing, debt rescheduling and investment transactions for the year 2011/12;
c) provides an update on the risk inherent in the portfolio and outlines actions taken by the authority during the year to minimise risk;
d) gives details of the outturn position on treasury management transactions in 2011/12;
e) confirms compliance with treasury limits and Prudential Indicators (PI's) and outlines the final position on the PI's for the year.

1.8 In accordance with TMP note 6, the report is required to be presented to Full Council.

1.9 The Treasury Management Practices for 2012/13 have been updated for changes in the 2012-13 Treasury Management Strategy and the revised CIPFA Treasury Management Code of Practice. The updated practices are attached at Appendix 3. These require approval by Audit Committee.

2. The Economy and Events in 2011/12

2.1 Before reviewing the Council's performance for the year it is appropriate to outline the national and economic background within which Council Officers operated during 2011/12:

2.2 At the time of determining the 2011/12 strategy in January 2011, there were tentative signs that the UK was emerging from recession with the worst of the financial crisis behind it. Recovery in growth was expected to be slow and uneven as the austerity measures announced in the 2010 Comprehensive Spending Review were implemented in order to bring down the budget deficit and government borrowing and rebalance the economy and public sector finances. Inflation measured by the Consumer Price Index (CPI) had remained stubbornly above 3%. Unemployment was at a 16 year high at 2.5 million and was expected to rise further as the public and private sector contracted. There was a also high degree of uncertainty surrounding Eurozone sovereign debt sustainability.

2.3 **Inflation :**

During 2011-12 inflation remained high with CPI (the official measure) and RPI rising in September to 5.2% and 5.6% respectively primarily due to escalating utility prices and the January 2011 increase in VAT to 20%. Inflation eased slowly as reductions in transport costs, food prices, intensifying competition amongst retailers and supermarkets and the VAT effect falling out in 2012, pushed February 2012's CPI down to 3.4% and RPI to 3.7%. This, however, was not enough to offset low wage growth and, as a result, Britons suffered the biggest drop in disposable income in more than three decades.

2.4 **Growth, Employment, House Prices :**

Growth, on the other hand, remained elusive. The Bank's Quarterly Inflation Reports painted a bleak picture as the outlook was downgraded to around 1% in 2011 and 2012 alongside. The unresolved problems in the Eurozone weighed negatively on global economic prospects. UK GDP was positive in only the first and third calendar quarters of 2011; annual GDP to December 2011 registered just 0.5%. Unemployment rose to 2.68 million and, worryingly, youth unemployment broke through the 1 million barrier. House prices struggled to show sustained growth and consumer confidence remained fragile.

2.5 **Monetary Policy :**

It was not surprising that the Bank of England's Monetary Policy Committee maintained the status quo on the Bank Rate which has now been held at 0.5% since March 2009, but increased asset purchases by £75bn in October 2011 and another £50bn in February 2012 taking the Quantitative Easing (QE) total to £325bn.

The policy measures announced in the March 2012 Budget statement were judged to be neutral. The government stuck broadly to its austerity plans as the economy was rebalancing slowly. The opinion of independent Office for Budget Responsibility (OBR) was that the government was on track to meet its fiscal targets; the OBR identified oil price shocks and a further deterioration in Europe as the main risks to the outlook for growth and in meeting the fiscal target.

2.6 **United States of America:**

The US economy continued to show tentative, positive signs of growth alongside a gradual decline in the unemployment rate. The US Federal Reserve (the Fed) committed to keeping policy rates low until 2014, although a modest shift in the Fed's language in March, alongside an improvement in economic activity, cast doubts about the permanence of the Fed's policy commitment.

2.7 **Europe:**

In Europe, sovereign debt problems for some peripheral countries became critical. Several policy initiatives were largely ineffectual; two bailout packages were required for Greece and one for Portugal, and the contagion spread to Spain and Italy whose sovereign bonds came under increased stress in November. Standard & Poor's downgraded nine European sovereigns and the EFSF bailout fund. The successful Greek sovereign bond swap in March 2012 shortly after its second bailout package allowed it to avoid bankruptcy later that month, but it was not a long-term solution. The ECB's €1.3 trillion Long-Term refinancing Operations (LTROs) flooded the financial markets with ultra-cheap 3-year liquidity and relieved much of the immediate funding pressure facing European banks in 2012, but markets ultimately took the view the LTROs simply served to delay a resolution of, rather than addressed, the fundamental issues underpinning Euroland's problems.

Markets sentiment oscillated between 'risk on'/'risk off' modes, this swing becoming the norm for much of 2011/12 as investors shifted between riskier assets and the relative safety of higher quality government bonds. Gilts, however, were a principal beneficiary of the 'risk-off' theme which helped push yields lower. There was little market reaction to or impact on gilts by the decision by Fitch and Moody's to change the outlook on the UK's triple-A rating from stable to negative. Over the 12-month period from April 2011 to March 2012, 5-year gilt yields more than halved from 2.40% to 1.06%; 10-year gilt yields fell from 3.67% to 2.25%; 20-year yields fell from 4.30% to 3.20% and 50-year yields from 4.20% to 3.35%. PWLB borrowing rates fell commensurately (see table 2 in appendix 2), but the cost of carry associated with borrowing longer-term loans whilst investing the monies temporarily until required for capital financing remained high, in excess of 4.1 % for 20-year PWLB Maturity borrowing.

2.8 **Credit:**

Europe's banking sector was inextricably linked with the sovereign sector. Sharp moves in sovereign CDS and bond yields were fairly correlated with the countries' banking sector performance. The deterioration in the prospects for real growth had implications for earnings and profit growth and banks' creditworthiness. The European Banking Authority's banking stress tests of 70 EU banks undertaken in October 2011 identified a collective €106 billion shortfall to banks' Core Tier 1 ratio of 9%. The slowdown in debt and equity capital market activity also had implications for banks' funding and liquidity. These principal factors, as well as a reassessment by the rating agencies of future sovereign support for banks, resulted in downgrades to the long-term ratings of several UK and non-UK financial institutions in autumn 2011.

2.9 Appendix 2 outlines the various Interest rates in force during the year.

3. The Council's Strategy for 2011/12

3.1 The Council's Treasury Management Strategy was approved by full Council on 28th February 2011. As an overriding principle, the strategy proposed that in the current financial climate the Council would continue to minimise risk contained within its current debt and investment portfolios by establishing an integrated debt management and investment policy which balanced certainty and security, with liquidity and yield. The Council would continue to make use of short term variable rate borrowing, whilst at the same time seeking to balance its investments across a range of investment instruments.

3.2 Where possible the Council would continue to reduce the underlying level of long-term debt with the borrowing strategy for 2011/12 to meet the capital financing requirement from short-term fixed rate borrowing or variable rate borrowing where rates were lower than those available to the Council on its investments. Where borrowing rates were higher than investment rates internal resources would be used in lieu of borrowing with borrowing only taken to cover short-term cash flow requirements. Capital expenditure levels, market conditions and interest rate levels would be monitored during the year in order to minimise borrowing costs over the medium to longer term.

3.3 The mid-year report outlined the deterioration of credit condition through the year with the increase in sovereign debt problems in the Eurozone changing the strategy to a greater emphasis on internal borrowing reducing external borrowing and investments further reducing the credit risk of the Council's investment portfolio. This strategy was subject to constant review reacting to any changes in credit conditions.

Review of the Council's Performance 2011/12

4. Treasury Portfolio

4.1 Table 1 shows the Council's overall Treasury Portfolio at the end of 2011/12 compared to 2010/11.

Table 1

31/3/2011 £m	Average Interest rate %		31/3/2012 £m	Average Interest rate %
		External Borrowing Long-term:		
61.315	5.4001	PWLB	61.315	5.4001
130.000	4.4202	Market	130.000	4.4202
0.083	1.1660	Bonds	0.083	1.1668
94.985	0.4800	Temporary Borrowing	15.000	0.2900
286.383	**3.3222**	**Total PCC Borrowing**	**206.398**	**4.4098**
		Long-term liabilities		
31.753	8.7300	PFI Schemes	31.017	8.7300
3.263	n/a	Finance leases	2.585	n/a
35.016		**Total Long term Liabilities**	**33.602**	
321.399		**Total External Debt**	**240.000**	
(165.802)	1.7207	**Total Investments**	**(83.975)**	1.0564
155.597		**Net Borrowing/(Net Investment) Position**	**156.025**	

4.2 The total external debt as shown above includes long term liabilities in respect of PFI schemes or finance leases as these liabilities are seen as a credit arrangement thus increasing the Council's total debt and must be taken into account within the statutory borrowing limits. The Council has one PFI scheme, the contract with Pyramid to build and run the schools at Woodview campus and Riverside. The move to producing statutory accounts on an International Financial Reporting Standard (IFRS) basis has resulted in a reclassification of a number of leases from operating to finance leases. These were added to the Council's Balance Sheet in 10-11 and previous years Balance Sheets restated as appropriate.

The total investments include £21.49m invested on behalf of the Heart of the South West Local Enterprise Partnership (LEP) in respect of the Growing places Fund. This balance was received in two payments with £6.978m received on 21st February 2012 and £14.51m on 29th March 2012. These funds were deposited in call accounts with interest credited to the fund balance. The fund will be distributed subject to approved bids across the LEP region and over time the amount invested by the Council on behalf of the LEP will reduce.

5. Borrowing

5.1 The borrowing strategy for the year, should market conditions allow, was:

- To reduce the underlying level of long term debt.
- To manage out the risk inherent in the existing portfolio in terms of market loans to PWLB by exercising call options on Lobo's where the opportunity was available.

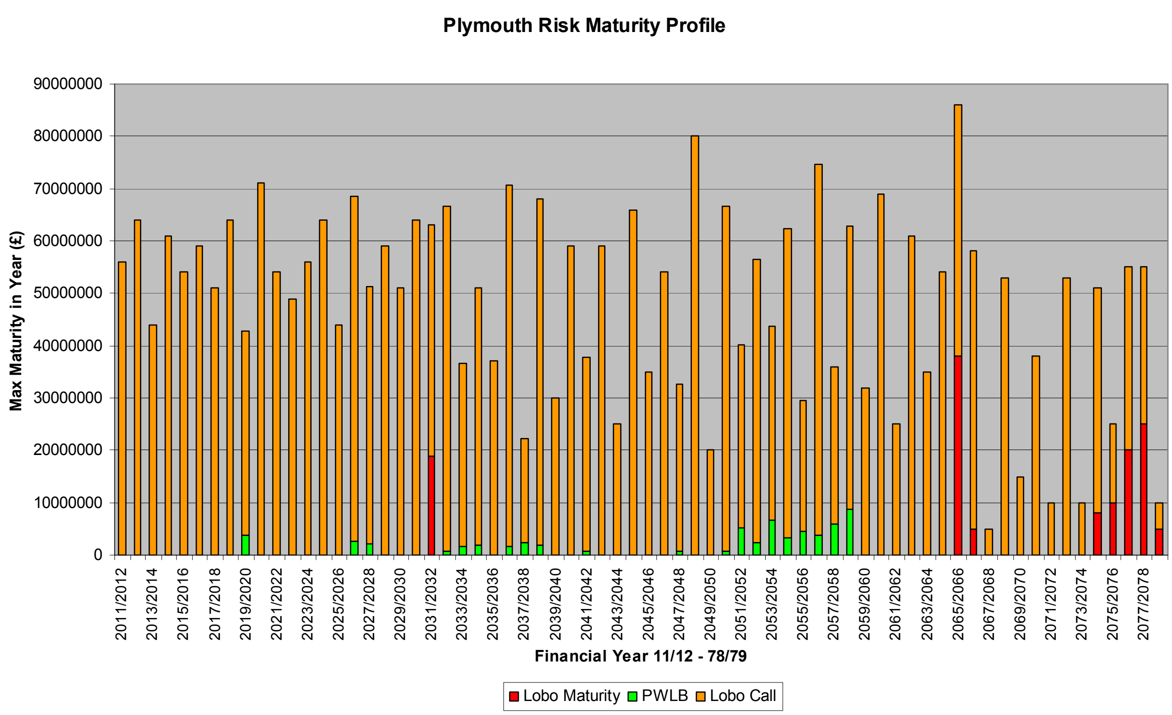
5.2 After considering the risks inherent in the existing portfolio and the outlook for interest rates in the short term, the capital financing borrowing requirement for

2011/12 was to be financed from short-term fixed rate borrowing or variable rate borrowing where rates were lower than those available to the Council on it's investments. Where borrowing rates were higher than investment rates internal resources would be used in lieu of borrowing with borrowing only taken to cover short term cash flow requirements. Capital expenditure levels, market conditions and interest rate levels would be monitored during the year in order to minimise borrowing costs over the medium to longer term.

5.3 Figure 1 below shows the maturity profile of the long term debt for the Council as at 31 March 2012.

5.4 The debt portfolio continues to include £130m of LOBO (market) loans. These loans have various option call dates where the banks have the ability to amend the loan terms and at which point the Council could choose to repay the loan if the terms are changed adversely. This is reflected within the maturity profile shown above (in amber) to enable officers to risk manage the Council's cashflows. During the year £56m of LOBO loans entered the period where they could have been called, but options were not exercised by the relevant banks.

Figure 1



5.5 Under Section 3 of the Local Government Act 2003 and supporting regulations the Council must determine and keep under review how much it can afford to borrow. The Council is required to set two limits:

- The Authorised Limit – This is the statutory limit which should not be breached. This can only be amended with the approval of Full Council.
- The Operational Boundary – This is based on the same estimate as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

5.6 The borrowing limits for 2011/12, originally approved by Council in March 2011, were as follows:

- Authorised limits £368m
- Operational Boundary £343m

The revised prudential indicators, as approved by Council on 27 February 2012, reduced the limits to fall in line with the Council's strategy to reduce debt when credit conditions worsened as was the case in the second half of the year. The approved updated limits were as follows:

- Authorised limits £291m
- Operational Boundary £271m

5.7 The Director for Corporate Services confirms that there were no breaches to the Authorised Limit and Operational Boundary during the year. The maximum debt outstanding during 2011/12 was £325.959m on 11 April 2011 (including £35.016m for the PFI and finance lease liabilities). This was within both the authorised limit and the operational boundary. Following the reduction in borrowing limits in February 2012 the maximum debt outstanding reached £241.414m on 20 March 2012. This again was within both the updated authorised limit and operational boundary.

5.8 Table 2 shows the movement in the borrowing portfolio during the year..

Table 2 Movement in Borrowing Portfolio

	Balance on 01/04/11 £000s	Debt Maturing £000s	Debt Repaid £000s	New Borrowing £000s	Balance on 31/03/12 £000s	Increase/ (Decrease) in Borrowing
Short Term Borrowing	94,985	(669,585)		589,560	15,000	(79,985)
Long Term Borrowing	191,398				191,398	0
Total Borrowing	**286,383**	**(669,585)**	**0**	**589,560**	**206,398**	**(79,985)**

5.9 In accordance with the Council's treasury management strategy no long term borrowing was taken in 11-12 however as a result of market conditions it was not possible to reduce long term borrowing. Due to the movement in Gilts and the resulting reduction in PWLB rates the cost of repaying any of our PWLB loans early was prohibitive. No lenders options were taken on any of the Council's Lobo loans and as a result we were not able to exercise the Council's option to repay at no cost. Despite this the Council's borrowing reduced from £286.383m to £206.398m, a reduction of £79.985m in short-term loans offset by a reduction in short-term investments.

5.10 The Council's underlying need to borrow as measured by the Capital Financing Requirement (CFR) as at 31March 2012 was estimated at £270.235m (including PFI and Finance leases).

5.11 New borrowing in year

The use of short-term borrowing has been the most cost effective means of financing of capital expenditure and cashflow requirements. Matching short-term borrowing with the availability of liquid deposits held in bank call accounts lowered overall treasury risk by allowing flexibility to reduce debt and investment levels at short notice when credit conditions deteriorated during the year.

At the start of the year the Council had £94.985m of short term loans. These are generally taken for periods of less than 30 days, repaid and replenished with new loans as subject to availability and favourable rates during the year. At the end of the year the Council had £15m of short term loans.
The average period of new loans taken in the year was for 24.95 days at an average interest rate of 0.36%. This is below the bank base rate. Short term loans are generally taken from other local authorities.

5.12 Debt Repayment

There was no loan repayments made in 2011-12. The reduction in loans is a result of short-term loans not being replaced on maturity.

5.13 Debt Rescheduling

There has been no debt rescheduling in the period due to falling interest rates making the repayment of any PWLB loans more expensive. Officers along with the Council's advisers Arlingclose will continue to monitor PWLB interest rates looking for opportunities to repay any debt maximising the savings achieved whilst maintaining a balanced maturity profile.

5.14 Overall Debt Performance for the year

The average interest rate on the Council's borrowing has increased over the course of the year from 3.322% to 4.4098%. This rate reflects the position at the end of each financial year (i.e. 31 March 2011 and 2012). The increase in rates is due to the repayment of low rate short-term loans using internal balances as credit conditions worsened over the second half of the year. Loan transactions were taken at various times throughout the year at various rates and, taking all transactions in the year, the overall average borrowing rate for 2011/12 was 3.9652% compared with a rate of 3.5476% for 2010/11.

6. Investments

Managing Investment Risk

6.1 The Guidance on Local Government Investments in England gives priority to Security and Liquidity of investments and the Council's aim is to achieve a Yield commensurate with these principles.

6.2 <u>Security</u>

Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2011/12 This restricted new investments to the following, although as indicated not all of the instruments were used during the year:

- The Debt Management Office
- Other Local Authorities (not used in 2011/12)
- AAA-rated Stable Net Asset Value Money Market Funds (not used 2011/12)
- Call Accounts and deposits with UK Banks and Building Societies systemically important to the UK banking system and deposits with select non-UK Banks (Australia, Canada, Finland, France, Germany, Netherlands, Spain, Switzerland and the US). (Only deposits with UK banks used in 2011/12)
- Bonds issued by Multilateral Development Banks, such as the European Investment Bank (not used 2011/12).
- Treasury Bills (T-Bills) (not used in 2011/12)

6.3 The long-term credit rating criteria used at the start of the year as per the approved investment strategy for 2011-12 was amended on 29th November 2011 as approved by Cabinet to A-/A3 in response to downgrades in credit ratings below A+ of many institutions considered to be systemically important to the financial system. The downgrades were driven principally by the credit rating agencies' view on the extent of future government support (flowing from the recommendations to the government from the Independent Commission on Banking) rather than deterioration in the institutions' creditworthiness.

6.4 Table 3 summarises the counter parties available during the year together with the approved limits. The Counter Party list is kept under constant review and counter parties removed or limits adjusted as appropriate.

Table 3 Approved Counter Party Listing in force 31 March 2012

Financial Asset Category	Criteria	Maximum Investment	Maximum Investment Term
Government Debt Office	Central Government Office	No Limit	12 Months
UK Banks and Building Societies	Minimum credit rating: Fitch – Long-Term A- Short-Term F1 Moody's – Long-Term A3 Short-Term P-1 S&P – Long-Term A- Short-Term A-1	£30m	12 Months
Foreign Banks	Minimum credit rating: Fitch – Long-Term A- Short-Term F1 Moody's – Long-Term A3 Short-Term P-1 S&P – Long-Term A- Short-Term A-1	£10m	12 Months

Local Authorities	Unitary Councils County Councils Metropolitan Councils London Borough Councils	£5m	12 Months
Money Market Funds	AAA with Constant Net Asset value investing predominantly in Government securities. AAA with a Constant Net Asset investing in instruments issued primarily by financial institutions.	2.5% of overall investment portfolio	Call
Bonds Issued by Multilateral Development banks	AAA or Government Guaranteed Eurosterling Bonds	Total investment £20m or 10% of investment portfolio	10 years

6.5 The limits placed on deposits with UK Banks and Building Societies and foreign banks were reviewed during the year as credit conditioned worsened with problems in the Eurozone and a number of banks were downgraded. The Investment Strategy for 2011-12 approved by Council in February 2011 allowed for deposits up to 2 years. In practice deposits were limited to shorter periods. In May 2011 limits on deposits with Non-UK banks were reduced from 2 years to 12 months. In August 2011 UK, Australian, Canadian and US bank deposits were limited to 6 months with European banks reduced to maximum maturities of 1 month as credit conditions in the Eurozone deteriorated. In September 2011 all French banks were suspended from the Council's list of available institutions for investments. In December 2011 the maximum limit for any deposit for any deposit was limited to 3 months with all European banks suspended. Towards the year end credit conditions improved and at the 31st March 2012 the limits in place for deposits were as follows:

UK Banks:
Santander UK Plc. up to 35 days
Barclays Bank Plc up to 100 days
Lloyds Banking Group up to 100 days
Royal Bank of Scotland Group up to 100 days
HSBC Bank Plc up to 6 months
Standard Chartered Bank up to 6 months

Australian/Canadian/USA banks:
Maximum deposit maturities up to 6 months.

All investments made in 11-12 were with UK banks and the Nationwide Building Society.

6.6 Figure 2 below shows the actual split of deposits by country/sector as 31 March 2012. Table 4 provides more detail on the actual deposits by counter party group. These deposits include £21.49m invested on behalf of the Heart of the South West LEP.

Figure 2

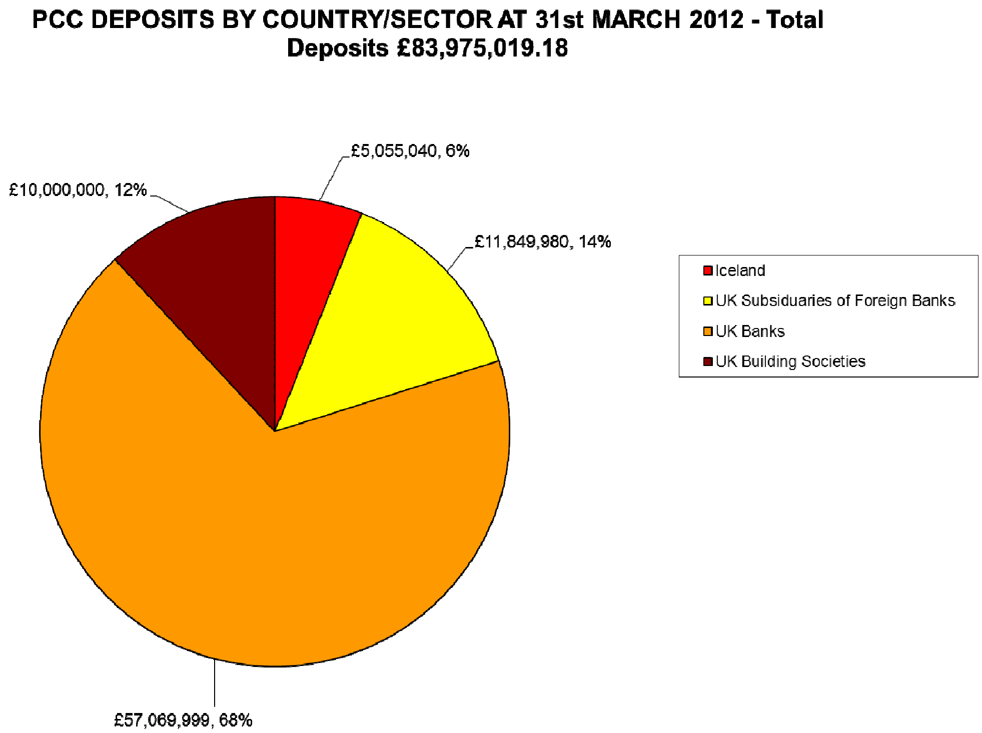


Table 4

Group	Bank/Institution	PCC deposits £m	LEP deposits £m	Total deposits £m
RBS Group	Royal Bank of Scotland	16.600	4.500	21.100
Lloyds Banking Group	Bank of Scotland	11.450	5.750	17.200
Barclays Banking Group	Barclays	13.020	5.750	18.770
Nationwide Building Society	Nationwide Building Society	10.000		10.000
Banco Santander Group	Santander UK	6.361	5.489	11.850
Iceland deposits	Landsbanki Island	2.835		2.835
	Heritable Bank	0.962		0.962
	Glitnir	1.258		1.258
Total Deposits @ 31st March 2012		**62.486**	**21.489**	**83.975**

6.7 The movement in the investment portfolio during the year was as follows:

Table 5 **Movement in Investment Portfolio**

Investments	Balance on 31/3/11 £000	Investments Made £000	Maturities/ £000	Balance on 31/03/12 £000	Avg Rate % / Avg Life to maturity (days)
Short Term Investments (less than 1 year)	149,802	519,915	(590,742)	78,975	1.39%/ 38days
Long term Investments (over 1 year)	16,000	5,000	(16,000)	5,000	2.65%/ 118 days
Total Investments	**165,802**	**524,915**	**(606,742)**	**83,975**	

6.8 The majority of the short term deposits were held in call or short term notice accounts. In line with the Council's approved investment strategy for 2011/12 the following longer term deposits were taken in the year:

Amount	Start Date	End Date	Term (days)	Rate %
£1.0m	15/04/11	14/10/11	182	1.42
£1.0m	09/05/11	09/11/11	184	1.41
£5.0m	13/05/11	27/07/12	441	2.65
£5.0m	02/06/11	02/12/11	183	1.03
£5.0m	02/06/11	31/05/12	364	1.41
£1.0m	08/06/11	08/12/11	183	1.41
£5.0m	14/06/11	12/06/12	364	1.53
£5.0m	04/08/11	06/02/12	186	1.04
£5.0m	04/08/11	02/08/12	364	1.42

6.9 The above deposits have been taken above target rates and increased the return on investments in 2011/12. The maximum approved term for new deposits in 2011/12 was 2 years.

6.10 CLG investment guidance which came into effect 1 April 2010 recommended that strategies should show details of assessing credit risk. Counterparty credit quality is assessed and monitored with reference to:

- Credit Ratings (Council's minimum long-term counterparty rating of A+ across all three rating agencies, Fitch, S&P and Moody's); Amended to A- on 29th November 2011.
- Credit Default Swaps;
- GDP of the country in which the institution operates;
- the country's net debt as a Percentage of GDP;
- Sovereign Support Mechanisms /potential support from a well-resourced parent institution;
- Share Price.

6.11 The Council's treasury advisors, Arlingclose, have developed a matrix to score the credit risk of an authority's investment portfolio. The matrix allocates a numerical score based on the credit rating of an institution, with a AAA rated institution scoring 1, and a D rated institution scoring 15. This is then weighted to reflect both the size of the deposit and the maturity term of the deposit. The aim is to achieve an overall score of 5 or lower on both weighted averages to reflect an investment approach based on security. The lower the score the better the security of the deposit.

6.12 Table 6 shows the rating currently attached to the Council's portfolio and its movement during the year using this matrix.

Table 6 **Credit Risk Matrix**

Date	Value Weighted Average – Credit Risk Score	Value Weighted Average – Credit Rating	Time Weighted Average – Credit Risk Score	Time Weighted Average – Credit Rating
31/03/2011	4.20	AA-	4.75	A+
30/06/2011	4.24	AA-	4.58	A+
30/09/2011	4.37	AA-	4.68	A+
31/12/2011	5.39	A+	5.35	A+
31/03/2012	5.48	A+	5.42	A+

Note : These scores exclude any deposits with Icelandic banks.

Based on the scoring methodology, the Council's Counterparty credit quality has reduced over the course of the year. This is due to the credit rating downgrade of the Counterparties used by the Council. All Council deposits in 11-12 have been made with UK banks considered to be systemically important to the UK financial system. The credit risks score has moved above the target of 5 for the year. This target has increased to 7 for 12-13 in light of the credit rating downgrades. Council officers are reviewing alternative invests to reduce the credit score of the Council's investment portfolio. Section 6.15 compares the authority's performance with that of other authorities who are clients of Arlingclose.

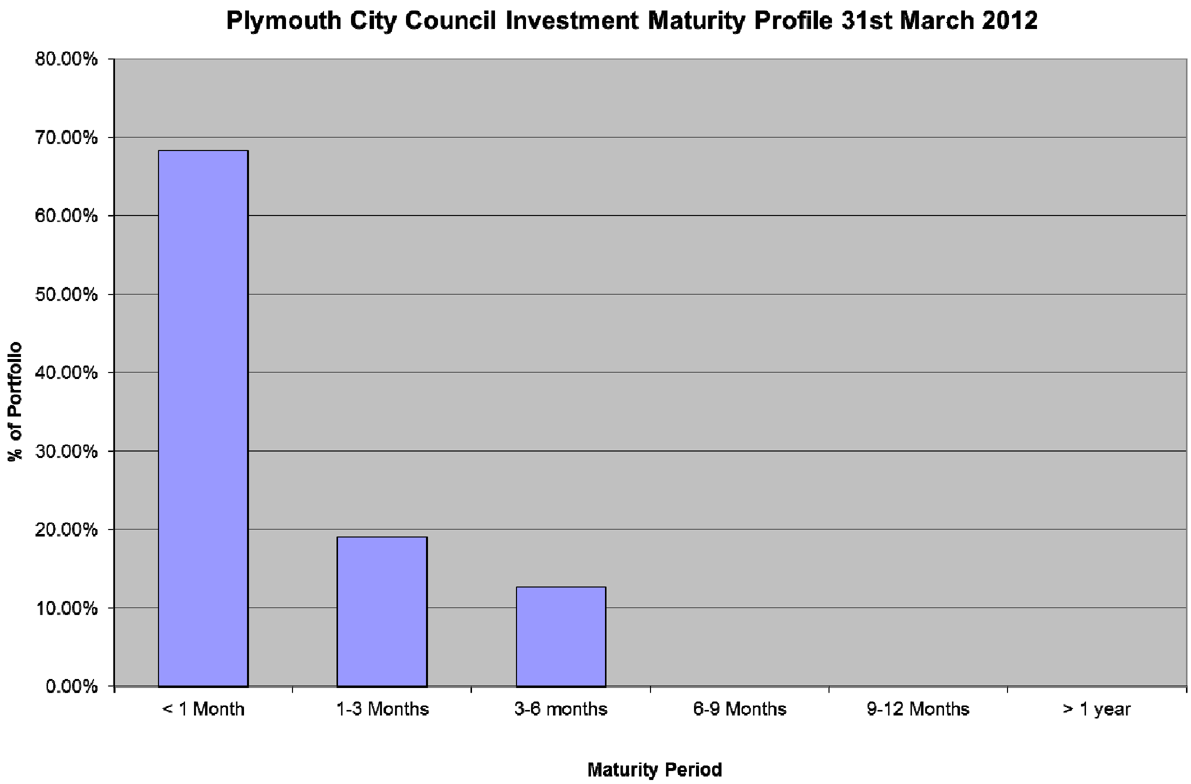
6.13 Liquidity

In keeping with the CLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of overnight deposits and the use of call accounts.

6.14 The maturity profile of the Councils deposits is represented in figure 3. This shows a large proportion of deposits maturing in less than one month reflecting the deposits in call accounts giving the liquidity requirement to cover any adverse changes in market conditions. The Treasury Management Board has set a requirement that at least £15m should remain within callable deposits at all times.

6.15

Figure 3



6.15 Yield- Investment performance for the year

The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate was maintained at 0.5% through the year.

6.16 Investments are made short-term to cover cashflow and liquidity requirements and longer-term to maximise and guarantee future income. During 2011/12 the Council invested for a range of periods from overnight to 15 months, dependent on the Council's cash flows, Officer's interest rate view, the interest rates on offer and the economic climate/credit risk. The Council's treasury management officers work to a benchmark rate of return, the 7 day London Interbank Bid (LIBID) rate – which is the rate which can be achieved on the London interbank market for cash deposits of 7 days and is regarded as the standard benchmark. The 7 day rate is calculated on a daily basis and averaged for the year. Table 7 below compares the average return achieved by the in-house team with the benchmark. An average rate of 1.02978% was achieved for new investments (including investments made on behalf of the LEP) in the year against a budget of 1%.

Table 7

	Weighted Average Investment	Benchmark Rate %	Actual Return %
Internally Managed:	£127.035m	0.54	1.3647

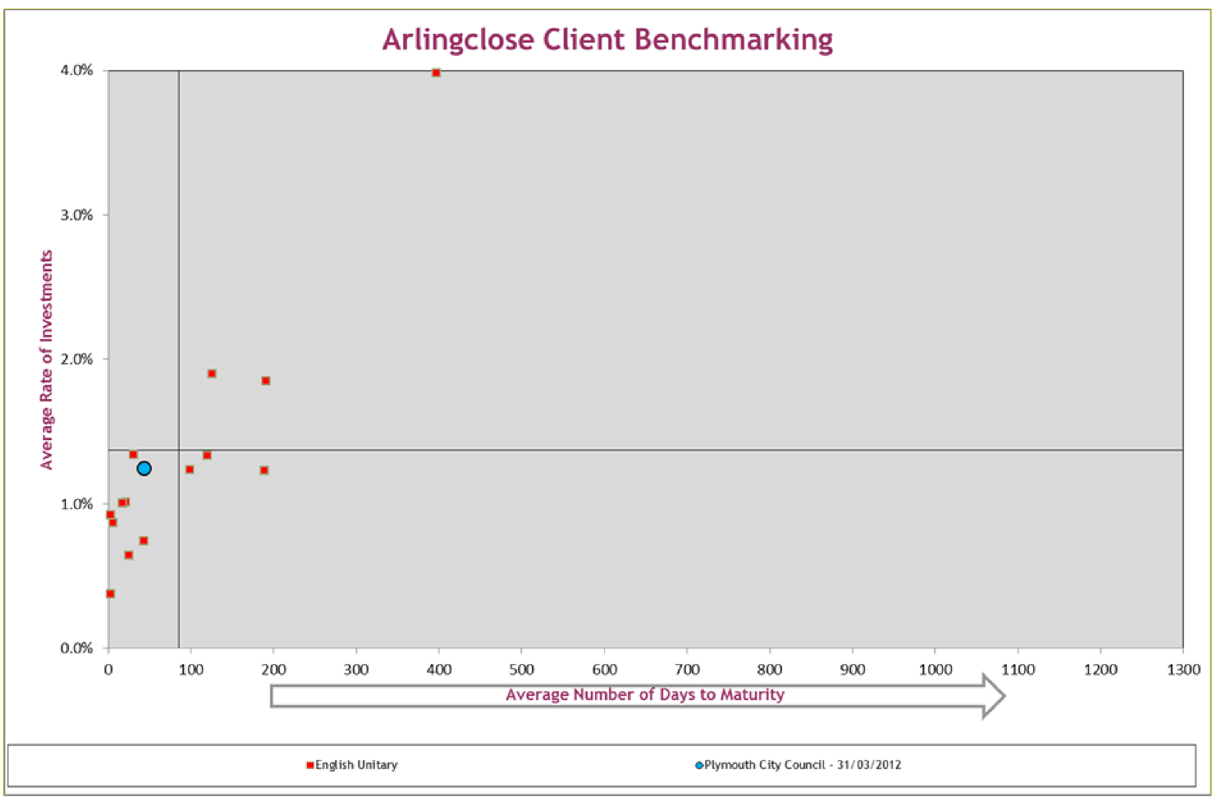
The table shows that the internal performance exceeded the benchmark for the year, despite the restricted investment counterparty list and the tighter limitations placed on deposits in the second half of the year.

6.17 As outlined above, Arlingclose have developed a set of benchmarking criteria to enable comparisons on investment performance to be made on data provided by all their clients. To compare like with like the following graphs compare our investment performance with other Unitary authorities. This is based on data provided to 31 March 2012. The results of the benchmarking are discussed at regular strategy meetings with the Advisors. The benchmarking has to be taken in the context of risk appetite and the legacy investments that the Council has in its portfolio.

6.18 The graphs used for comparison are:

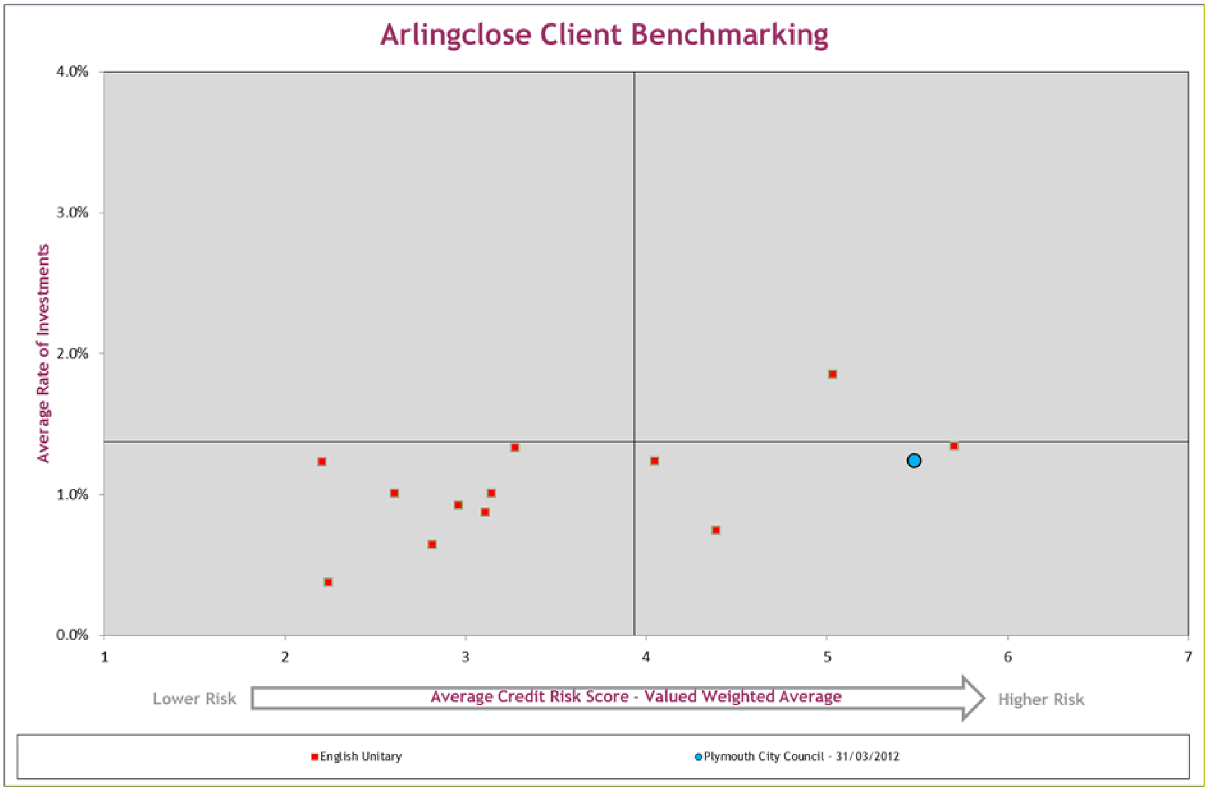
1. Average rate of investments against average maturity period
2. Average rate of investments against value weighted average credit risk score
3. Average rate of investments against time weighted average credit risk score

Graph 1 Average Number of days to Maturity V Return



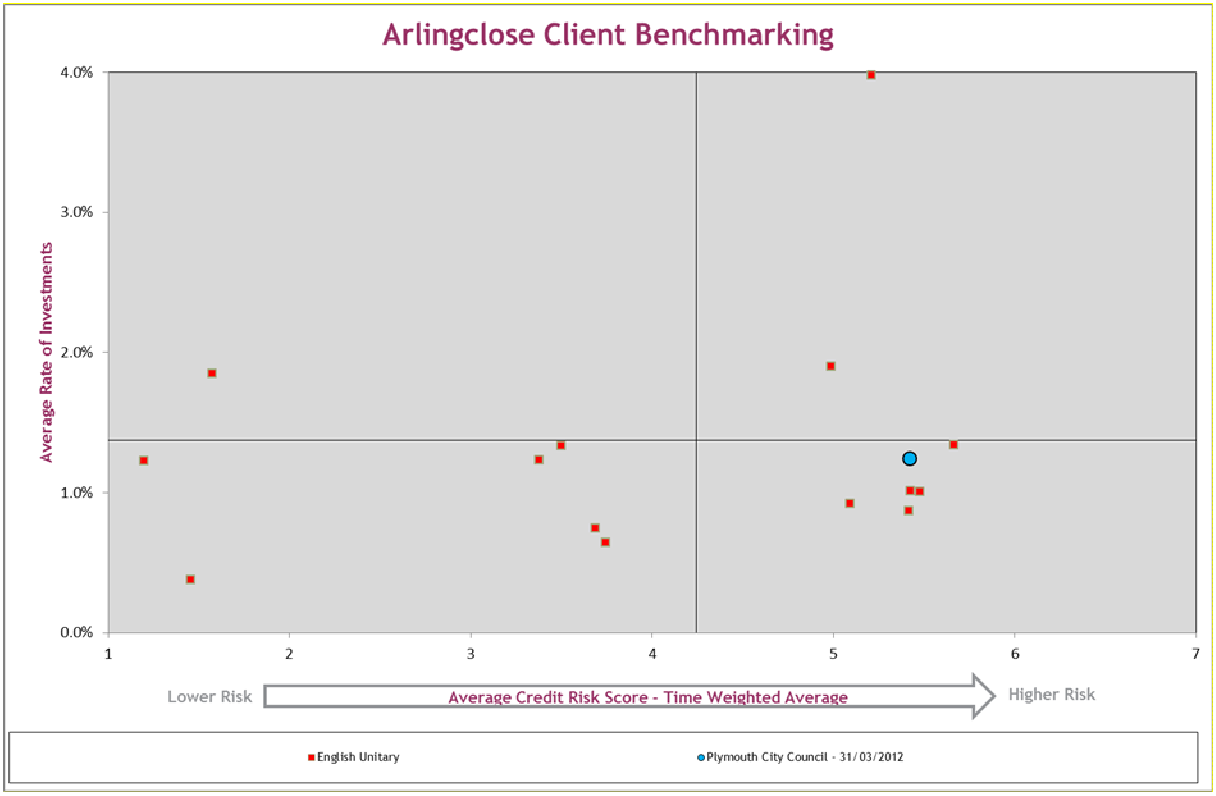
This graph shows the duration of investments against return. It shows the Council's investments have performed well against other unitary authorities. Despite reducing maturity periods of deposits the Council's return on investments as held up as a result higher rates negotiated by the treasury management officer on the Council's call accounts.

Graph 2 Value Weighted Average V Return



As a general rule the aim should be to convert a greater average length of portfolio duration into a greater than average return. There should be a positive correlation between duration and return. However, this chart should not be viewed in isolation from other measured parameters and it should be noted that a high Average number of days to maturity does not necessarily mean a higher risk, in fact the reverse may be considered to be true in some cases. As can be seen from this graph, Plymouth City Council is converting duration into a higher return than many of their peer group. However with the maturity of some of the higher rate deposit previously held in the Council's portfolio and the credit rating downgrades for the banks currently used for the Council's deposits the Council's score has increased over time. Council officers will look at alternative investment to reduce the credit risk of the Council's investments.

Graph 3 Time Weighted Average V Return



Longer term investments are inherently more risky. Ideally authorities should move towards the top left hand corner of the graph. Therefore it is preferable to see risk taken converted into return at a greater than average rate. This should be seen as a longer term goal within the Council's investment portfolio which has been affected by a number of rating downgrades on legacy investments and on banks currently used increasing the credit risk score. As previously stated Council officers are investigating alternative investments that will reduce the credit risks. However this may impact on the returns achieved by the Council.

7. Icelandic Banks Update

7.1 The latest position on the recoveries of monies invested in the Icelandic banks is as follows:

7.2 Heritable Bank £3m

The Council received further dividends totaling 17.81p in the £ in 2011/12, made up of principal of £0.534m and interest of £0.027m, bringing total dividends paid to 31st march 2012 to 67.92%. A further dividend was received in April 2012 of 3.79p in the £ made up of principal of £0.114m and interest of £0.006m bringing the total dividends paid to date to 71.71%.

7.3 Glitnir £6m

In March 2012 the Council received £5.033m made up of principal of £4.742m and interest of £0.291m.

7.4 Landsbanki £4m

In February 2012 the Council's receipt amounted to £1.230m made up of principal of £1.165m and interest of £0.065m. In May 2012 the Council received a second distribution amounting to £0.517m made up of principal of £0.490m and interest of £0.027m

7.5 Impairment of Icelandic bank deposits

In the 09-10 Accounts impairment was calculated based on an estimate of future collections. At this point the impairment of the deposits was calculated as £5,903,956.28. To cover this impairment a capital direction was applied for and agreed to the value of £5.7m. This allowed the Council to capitalise this expenditure and spread the charge to revenue over 20 years. The remaining balance of £203,956.28 was met by a transfer from the internal Icelandic Bank reserve. This reserve had been created to cover Icelandic legal costs and losses on recovery of the Icelandic deposits. Following the receipt of dividends in 2011-12 and 2012-13 this impairment has been recalculated and reduced by £1,284,162.58 so the impairment is in line with the unrecovered deposits. This reductions means that part of the accounting entries made in 2009-10 can be reversed resulting in a transfer back to the Icelandic bank reserve of £203,956.28 increasing the balance in this reserve to £563,886.77. The remaining adjustment of £1,080,206.30 reduces the Council's borrowing requirement and the annual revenue charge over the next 18 years. Any additional receipts prior to the publication of the 11-12 Statement of Accounts will result in an amendment to these accounts and a further reduction in the impairment.

7.6 Further recoveries

The Council continues to pursue recovery of the outstanding monies through the Icelandic Courts in partnership with the LGA. The cost of the continuing external legal advice has been met from the Council's internal reserve set up for Icelandic bank issues. A sum of £0.020m has been incurred in 2011/12.

8. Revenue Implications of Treasury Management

8.1 The expenditure arising from the Council's borrowing and lending accrues to the revenue accounts. This includes interest payable and receivable, the minimum revenue provision (for debt repayment), and premiums and discounts written out to revenue from previous debt rescheduling. Some of the interest receivable is passed onto specific accounts where this interest has accrued from the investment of surplus balances for these services. The balance (net cost) is met by the General Fund. Table 8 below shows the income and expenditure arising from these transactions in 2011/12.

8.2 The net cost of capital financing to the General Fund in 2011/12 reduced by £0.388m from the 2011/12 budget due to a reduction in MRP of £0.267m, reduced treasury management costs of £0.190m and other cost increases of £0.039m. The MRP is a statutory charge to revenue based on the Council's capital expenditure financed from borrowing. The reduction in treasury management costs is due to use of low rate short term borrowing as an alternative to the use of internal balances to fund capital expenditure and a reduction in debt management costs. Additional MRP and interest payments resulted from PFI schemes however this was matched by grant funding.

Summary of Capital Financing Costs 2011/12

Table 8

	2011/12 Budget £000	2011/12 Outturn £000	Variance £000
External Interest payments	8,872	9,235	3,632
Interest payable (PFI)	0	2,773	2,773
External Interest received	(1,593)	(2,080)	(487)
Interest transferred to other accounts	50	140	90
Premiums / Discounts written out to Revenue	(189)	(189)	0
Debt Management Expenses	130	115	(15)
Treasury Management Cost	**7,270**	**9,994**	**2,724**
Minimum Revenue Provision	7,285	7,018	(267)
Minimum Revenue Provision (PFI)	0	737	737
Recharges for unsupported borrowing	(1,588)	(1,512)	76
Recovered from trading Accounts	(3,332)	(3,480)	(148)
PFI Grant	0	(3,510)	(3,510)
Net Cost to General Fund	**9,635**	**9,247**	**(388)**

9. Compliance with Prudential Indicators

Under the arrangements set out in the Prudential Code for Capital Finance in Local Authorities, individual authorities are responsible for deciding the level of their affordable borrowing, having regard to the Code, and for establishing a range of Prudential Indicators covering borrowing limits and other treasury management measures. The compliance of borrowing with the Authorised Limit and Operational Boundary is confirmed in sections 5.5 to 5.7 of this report. The Prudential Indicators for 2010/11 were approved by Council on 28 February 2011and updated on 27th February 2012 as part of the approved Treasury Management strategy for 2012-13. The latest position on the indicators is set out in Appendix 1.

10. Balanced Budget

10.1 The Council complied with the Balanced Budget requirement.

11. External Service Providers

11.1 Arlingclose is appointed as the Council's treasury management advisor. The Council is clear as to the services it expects and is provided under the contract. The service provision is comprehensively documented. The Council paid a sum of £21,000 in 2011/12 for this service.

11.2 The Council is also clear that overall responsibility for treasury management remains with the Council.

12. Training

12.1 CIPFA's revised Code requires the Director for Corporate Support to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

12.2 The CLG's revised Investment Guidance also recommends that a process is adopted for reviewing and addressing the needs of the authority's treasury management staff for training in investment management.

12.3 The Council commissioned a Treasury Management awareness and training session from external consultants Griffiths Morley and this was delivered on 22 January 2010. The Council subsequently provided an updated session for members on 10 January 2011. Further training will be undertaken in 2012-13 following consultation with the Council's advisors, Arlingclose. The provision of 1 days training is included in the Contract agreed with Arlingclose for the next 3 years.

12.4 During the year, the Council's treasury management officer has successfully completed and been awarded a Certificate in International Treasury Management- Public Finance (CERT TM- PF). This is an accredited course for treasury management specialists in the Public Sector, supported by CIPFA. Officers also attend regular workshops and seminars on treasury management.

12.5 The Council continues to keep its training requirement under review.

13 Other Items

Potential for reduced PWLB borrowing rates

A brief paragraph in the 2012 Budget Report (March 2012) contained HM Treasury's intention to offer a 20 basis points discount on loans from the PWLB "for those principal local authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans" and the potential of an independent body to facilitate the provision of "a further reduced rate for authorities demonstrating best quality and value for money". More detail is awaited and, given that discussion with relevant bodies will be required, it could be some months before either of these measures is implemented. This will be taken into account in future decisions on any new long term borrowing and updates included in quarterly monitoring reports to Cabinet and the mid-year and annual Treasury Management reports to the Audit Committee and Council.

14. Recommendations

14.1 Audit Committee note the Treasury Management report for 2011/12.

14.2 The report be referred to Full Council as required under the CIPFA Treasury Management Code of Practice (TMP note 6).

14.3 Audit Committee approve the Treasury Management Practices as outlined at Appendix 3.