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CABINET

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TREASURY MANAGEMENT OUTTURN ANNUAL REPORT

Portfolio Holder:	Councillor Alan Jarrett, Deputy Leader and Finance
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Summary

This report gives an overview of treasury management activity during 2009/10.

1. Budget and Policy Framework

1.1 The council's treasury strategy and policy are approved by Full Council following consideration by Business Support Overview and Scrutiny and Cabinet. However, Full Council approved that reporting of the Treasury Management Annual Outturn is to Cabinet followed by Audit Committee.

2. Background

2.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2009 was adopted by this Council on 25 February 2010.

2.2 The Department for Communities and Local Government issued new guidance on local government investments on 11 March 2010. When Council approved the Treasury Strategy on 25 February 2010 the guidance was still in draft form and the report to Council stated that "A separate report will be made to members to inform them when this guidance has been finalised" This guidance has now been finalised and does not impact on the Treasury Strategy for 2010/11 and this Council fully complies with its requirements.

2.3 The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the Full Council of an annual treasury management strategy report (including the annual investment strategy report) for the year ahead, a midyear review report and an annual review report of the previous year. The receipt of the annual review report (Treasury Outturn report) has been delegated to the Audit Committee following Cabinet.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Business Support Overview and Scrutiny.

2.4 Treasury management in this context is defined as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

2.5 The purpose of this report is to meet one of the above requirements of the CIPFA Code, namely the annual review report of treasury management activities, for the financial year 2009/10.

2.6 This annual treasury report covers:

- the Council's treasury position as at 31 March 2010;
- borrowing activity 2009/10
- performance measurement;
- the strategy for 2009/10;
- the economy and interest rates in 2009/10;
- borrowing rates in 2009/10;
- the borrowing outturn for 2009/10;
- debt rescheduling;
- compliance with treasury limits and Prudential Indicators;
- investment rates in 2009/10;
- investment outturn for 2009/10.

3. Treasury Position as at 31 March 2010

3.1 The Council's debt and investment position at the beginning and end of the year was as follows.

Table 1 – borrowing and investment levels

	31 March 2010		31 March 2009	
Description of debt/investment	**Principal £m**	**Rate %**	**Principal £m**	**Rate %**
Borrowing				
- fixed rate borrowing	198.3		248.7	
- variable rate borrowing	0.1		0.1	
Total debt	198.4	3.76	248.8	4.14
Investments				
- in-house	66.6	2.85	112.4	5.83
- fund managers	22.2	1.25	21.9	6.27
Total investments	88.8		134.3	

4. Borrowing Activity 2009/2010

4.1 The borrowing strategy for the council confirmed the holding of £101.8 million in Lenders Options, Borrowers Options (LOBO) debt. These are debts that are subject to immediate repayment or variation of interest chargeable and the option to repay, on request from the lender on the review dates. However, the lender can only apply this clause once within the lifetime of the LOBO. This type of borrowing has therefore been classed as fixed rate. This is a change from the way these loans were classed last year. The figures within table 1 have been restated for 31 March 2009 to reflect this.

4.2 Due to the very low interest rates being earned on investments and restrictions to mitigate counterparty risk, officers have been repaying existing and deferring taking out new debt.

5. The Strategy for 2009/10

5.1 Within the original treasury strategy for 2009/10 approved by the Cabinet on 17 February 2009 the Sector view that the bank rate would continue falling from 2.0% in December 2008 to 0.5% in March 2009, which is held throughout 2009/10 before starting to rise in the second quarter of 2010. There was a downside risk to this forecast because if the recession proved deeper and longer than expected at that time; this would mean that the first rise in bank rate would be delayed.

5.2 Throughout 2009/10 the percentage earned on investments was exceeded by borrowing. The strategy applied during 2009/10 therefore applied in order to balance the impact of the loss in investment income there has been a re-evaluation of the benefits of new borrowing choosing to run down investment balances instead of taking new borrowing to finance new capital expenditure or to replace debt maturing during the year. This has also meant a reduction in exposure to counterparty and interest rate risk on the investment portfolio. There is a risk that borrowing costs may start to rise and the council is continuing to monitor this position in association with Sector.

6. The Economy and Interest Rates

6.1 During 2009/10 the Monetary Policy Committee (MPC) was focused on preventing the economy from moving into the deepest and longest recession the UK economy had experienced for many years. Despite keeping the bank rate at an historical low of 0.5%, the MPC also needed to pump liquidity into the economy through quantitative easing. This resulted in reduced borrowing costs for both the corporate and public sector.

6.2 The recession bottomed out in calendar quarter 1 of 2009 but the end of the recession did not materialise until the fourth quarter of 2009 when economic growth returned to +0.4%.

6.3 Inflation has not been a major concern of the MPC as it fell back below the 2% target level from June to November. It did spike upwards to reach 3.5% on the return of VAT to 17.5% on 1 January 2010 which was expected and inflation was forecast by the Bank of England to fall back under target by the of 2010.

7. Borrowing rates in 2009/10

7.1 PWLB borrowing rates throughout 2009/10 have been low across all time periods and particularly short term debt has been competitively priced at an average of 0.9% for one year money and 1.53% for two year money rising to an average of 3.93% for 10 year and 4.49% 25 year. None the less all of these rates have been greater than the investment returns achievable (with the exception on occasion of some very short term money which was then on a par).

7.2 The strategy developed as a reaction to these rates has been that as investments matured we have used funds to support borrowing. This policy is expanded upon in paragraph 8.2.

8. Borrowing Outturn for 2008/09

8.1 During 2009/10 no new borrowing was undertaken, however, at the beginning of the year some short term cash flow borrowing was in existence.

8.2 As highlighted in section 3 above the average debt portfolio interest rate has moved over the course of the year from 4.14% to 3.76%. The approach during the year was to use cash balances to finance new capital expenditure or maturing debt so as to run down cash balances and minimise counterparty risk incurred on investments. This also maximised treasury management budget savings, as investment rates were much lower than most new borrowing rates.

9. Debt Rescheduling

9.1 No debt restructuring was undertaken during 2009/10. Short term savings could be achieved by internally financing new capital expenditure and replacing maturing debt by running down existing cash balances which were only earning minimal rates of interest due to the fact that the bank rate was kept at 0.5% all year. Running down cash balances also meant reduced counterparty risk on the investment portfolio.

10 Compliance with Treasury Limits

10.1 During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement. The outturn for the Prudential Indicators is shown in appendix 1.

11 Investment Rates in 2009/10

11.1 Investment rates fell markedly during the first half of the year. Overnight rate varied little during the year within a range of 0.38 – 0.49%. The 3 month rate commenced on a high point for the year of 1.50% on 1.4.09, the rate fell gradually to reach a low of 0.42% in September before finishing the year at 0.52%. The 12-month rate started the year at 1.85% and fell steadily until reaching 0.85% in September. Since then it has risen to finish the year at 1.15% as the market looked ahead to when the MPC would have to start raising bank rate from its then current rate of 0.50%.

Table 2 – Investment rates 2009/10

	INVESTMENT RATES 2009-10					
	Overnight	7 Day LIBID	1 Month	3 Month	6 Month	1 Year
01-Apr-09	0.49%	0.55%	0.89%	1.50%	1.73%	1.93%
31-Mar-10	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
High	0.49%	0.55%	0.89%	1.50%	1.73%	1.93%
Low	0.38%	0.38%	0.38%	0.42%	0.61%	0.96%
Average	0.40%	0.42%	0.47%	0.73%	0.94%	1.29%
Spread	0.12%	0.17%	0.51%	1.09%	1.13%	0.97%
high date	01/04/2009	01/04/2009	01/04/2009	01/04/2009	01/04/2009	01/04/2009
low date	09/09/2009	02/10/2009	18/09/2009	29/09/2009	29/09/2009	28/09/2009

12 Investment Outturn for 2009/10

12.1 **Internally Managed Investments** – The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list. The council invests for a range of periods from overnight to 3 years, dependent on the Council's cash flows, the durational and counterparty limits set out in the approved investment strategy, its interest rate view and the interest rates on offer. During the year all investments were made in full compliance with the council's treasury management policies and practices.

12.2 **Investment Strategy** – Pending the issuance of revised CIPFA and statutory guidance expected towards the end of the year, and in the light of continuing stresses on the world banking system, enhanced priority was given to security and liquidity in order to reduce counterparty risk to the maximum possible extent. As noted earlier in this report, the opportunity was also taken to reduce debt levels by running down investment balances in order to further reduce exposure to counterparty risk and provide savings to debt management budgets.

12.3 In order to counter the downturn in investment rates and earnings following advice from Sector, a significant part of the investment portfolio was held in liquidity accounts with main UK banks. These accounts offered both instant access and rates which were often double those available in the money markets through brokers for overnight money and higher than most periods up to six months. In addition use was made of special deals with main UK banks for three months, which also offered substantially enhanced rates over the equivalent rates available through brokers.

12.4 **Externally Managed Investments** – The Council also has investments managed externally by Investec. The fund management agreement between the Council and the Fund Manager defines the limits for maximum weighting in gilts/bonds and maximum duration of the fund. Counterparty criteria and exposure limits are also pre-defined therein.

12.5 **Investment performance for 2009/10 –** Detailed below is the result of the investment strategy undertaken by the Council.

Table 3 Investment Performance 2009/10

	Average Investment	Rate of Return (gross of fees)	Benchmark Return *
Internally Managed	£94.062m	2.854%	7 Day uncompounded LIBID 0.421%
Externally Managed	£21.988m	1.251%	7 Day compounded LIBID 0.423%

12.6 No institutions in which investments were made during 2009/10 had any difficulty in repaying investments and interest in full during the year.

13 Financial and Legal Implications

13.1 Overall the Interest and Financing budget fell short of it's targeted budget by almost £600,000, however, the budget was predicated upon anticipated earnings of 3.32% on internal investments and 2% from the fund manager. In light of the continued financial crisis the rates achieved where only 2.85% and 1.25% respectively, this loss in interest earnings has been mitigated by the introduction of the policy described in paragraph 8.2 whereby, the borrowing costs have reduced by over £1million from the original budget in 2009/10, reducing the potential loss to Finance and Interest to just under £600,000. The body of the report and the appendices outline the significant financial implications. Any transactions undertaken on either investments or borrowings are governed by the London Code of Conduct, the council's treasury policy statement, and the CIPFA Code of Practice on Treasury Management in Local Authorities.

13.2 Legal implications – For the financial year 2009/10 our investments were managed in compliance with the Codes of Practices, guidance and regulations made under the Local Government Act 2003.

14 Risk management

14.1 Risk and the management thereof is detailed throughout this report but is set out in some detail in the Council's Treasury Management Strategy and in particular Treasury Management Practice (TMP) 1.

15 Recommendation

15.1 In accordance with the CIPFA Code of Practice, Cabinet is asked to note the content and recommend this report to Audit Committee

16 Suggested reasons for decision

16.1 In line with CIPFA's Code of Treasury Management Practice an annual report must be taken to Cabinet detailing the council's treasury management outturn within six months of the close of each financial year.

Appendices

Appendix 1 Prudential Indicators

Background papers

CIPFA Code of Practice on Treasury Management in the Public Services, the CIPFA Prudential Code for Capital Finance in Local Authorities and background advisory papers held by officers within the financial support division.

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Appendix 1

PRUDENTIAL INDICATORS

PRUDENTIAL INDICATOR	2008/09	2009/10	2009/10
(1). EXTRACT FROM BUDGET AND RENT SETTING REPORT	£'000	£'000	£'000
	Actual	Original	Actual Outturn
Capital Expenditure			
Non - HRA	£39,500	£76,427	£61.339
HRA (applies only to housing authorities)	£839	£7,179	£5,148
TOTAL	£40,339	£83,606	£66,487
Ratio of financing costs to net revenue stream			
Non - HRA	4.84%	5.00%	3.96%
HRA (applies only to housing authorities)	14.13%	13.32%	13.60%
Net borrowing requirement			
brought forward 1 April	£100,362	£107,425	£118,618
carried forward 31 March	£118,618	£105,843	£113,036
in year borrowing requirement	£18,256	£-1,581	£-5,582
Capital Financing Requirement as at 31 March			
Non – HRA	£207,907	£205,988	£208,901
HRA	£20,606	£21,341	£21,167
TOTAL	£228,513	£227,329	£230,068
Annual change in Cap. Financing Requirement			
Non – HRA	£10,314	£2,684	£995
HRA	£453	£453	£560
TOTAL	£10,768	£3,137	£1,555