Annual Report on the Treasury Management Service and Actual Prudential Indicators 2009/10

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WHY HAS THIS REPORT COME TO THE EXECUTIVE?

This annual treasury report is a requirement of the Council's reporting procedures. The information keeps the Executive informed of the treasury activity during 2009/10 and the actual Prudential Indicators for 2009/10.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. During 2009/10 the minimum reporting requirements were that the Council receive an annual treasury strategy in advance of the year and an annual report following the year describing the activity compared to the strategy (this report). In the future the Council will also receive a mid year treasury report following regulatory changes.

The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003

RECOMMENDATION:

That Executive recommend to:

(i) Approve the actual 2009/10 prudential indicators within the report

(ii) Note the treasury management stewardship report for 2009/10

(iii) Note a report on first half year of 2010/11 will be presented to a future Executive

Executive are also asked to note that this report will be presented to Audit Committee on 27 September, in its role as scrutiny.

1. INTRODUCTION

1.1. This report summarises:

- the capital activity during the year
- what resources the Council applied to pay for this activity;
- the impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- the reporting of the required prudential indicators;
- overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- a summary of interest rate movements in the year;
- the detailed debt activity; and the detailed investment activity

1.2 During 2009/10 the Council complied with its legislative and regulatory requirements. The actual prudential indicators for the year, with comparators, are as follows:

Actual Prudential Indicators	2008/09	2009/10
Actual Capital Expenditure	£4.64m	£6.21m
Capital Financing Requirement: Non-HRA	£7.35m	£7.13m
Financing Costs as a proportion of Net Revenue Stream: Council Tax	(8%)	(1%)

The Corporate Director-Resources and Transformation also confirms that borrowing was only undertaken for a capital purpose and the Statutory borrowing limit, the Authorised Limit, was not breached.

At 31 March 2010, the Council's external debt was £5m (£5m at 31 March 2009) and its investments totalled £18m (£20m)

The financial year 2009/10 continued the challenging environment of the previous year, although the second half of the year did see the UK economy recovering, albeit weakly. The main implications of the exceptional circumstances have been deteriorating investment returns and continuing counterparty risk.

2. The Council's Capital Expenditure and Financing 2009/10

2.1. The Council undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

2.2. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m	2008/09 Actual	2009/10 Estimate	2009/10 Actual
Total capital expenditure	**4.64**	**7.85**	**6.21**
Resourced by:			
Capital receipts	1.45	3.29	1.78
Capital grants	3.17	4.48	4.34
Capital reserves	0.02	0.08	0.09
Revenue			
Unfinanced capital expenditure	**0**	**0**	**0**

3. The Council's Overall Borrowing Need

3.1. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. It represents 2009/10 and prior years' net capital expenditure which has not yet been paid for by revenue or other resources.

3.2. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.

3.3. **Reducing the CFR** – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual treasury strategy, the Council is required to make an annual revenue charge to reduce the CFR – effectively a repayment of the Non-Housing Revenue Account (HRA) borrowing need.

3.4. This statutory revenue charge is called the Minimum Revenue Provision - MRP. The total CFR can also be reduced by:

- the application of additional capital resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

3.5. The Council's 2009/10 MRP Policy (as required by CLG Guidance) was approved on 24/02/2009.

3.6. The Council's CFR for the year is shown below, and represents a key prudential indicator. A key accounting change for 2009/10 was the inclusion of the PFI scheme on the balance sheet, which increase the Council's borrowing need, the CFR. No borrowing is actually required against this scheme as a borrowing facility is included in the contract.

3.7. Since the PFI scheme was brought on balance sheet, resulting in an increase in the Non HRA CFR, under new regulations the additional MRP required to be charged equates to part of the annual PFI charge. There is therefore no additional revenue impact.

CFR (£m)	31 March 2009 Actual	31 March 2010 Original Indicator	31 March 2010 Actual
Pre Adjustment Opening Balance	1.61	0	9.05
A Factor Adjustment	(1.70)	(1.70)	(1.70)
Adjusted Opening balance	0	0	7.35
Add unfinanced capital expenditure (as above)	0	0	0
Add adjustment for the inclusion of on-balance sheet PFI scheme	7.64	0	0
Less MRP		0	
Less PFI & finance lease repayments	**(0.20)**	**0**	**(0.22)**
Closing balance	**7.35**	**0**	**7.13**

**Members are asked to note, the PFI valuations are subject to audit confirmation and therefore provisional at this stage. Should any required changes be confirmed prior to the meeting an amended report will be circulated.

4. Treasury Position at 31 March 2010

4.1. During 2009/10 the Head of Finance and MIS took a cautious approach to managing the debt position. Additional borrowing was not found to be necessary and the treasury position at the 31 March 2010 compared with the previous year was:

Actual borrowing position	31 March 2009		31 March 2010	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	£5m	7.55%	£5m	7.55%
Variable Interest Rate Debt	£0m	0%	£0m	0%
Total Debt	**£5m**	**7.55%**	**£5m**	**7.55%**
Capital Financing Requirement	**£7.35m**		**£7.13m**	
Less PFI Liability	**(£7.44m)**		**(£7.22m)**	
Actual Borrowing	**(£5.00m)**		**(£5.00m)**	
Over/(Under) borrowing	**£5.00m**		**£5.00m**	
Investment position	**31 March 2009**		**31 March 2010**	
	Principal	**Average Rate**	**Principal**	**Average Rate**
Fixed Interest Investments	£18.60m	2.64%	£17.50m	0.78%
Variable Interest Investments	£1.61m	1.29%	£2.06m	0.41%
Total Investments	**(£20.21m)**	**2.52%**	**(£19.56m)**	**0.75%**
Net borrowing position	**(£15.21m)**		**(£14.56m)**	

5. Prudential Indicators and Compliance Issues

5.1. Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

5.2. **Net Borrowing and the CFR** - In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2008/09 plus the expected changes to the CFR over 2009/10 and 2010/11. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2009 Actual	31 March 2010 Original Indicator	31 March 2010 Actual
Net borrowing position	**(£15.21m)**	**(£16.36)m**	**(£14.56m)**
CFR	**£7.35m**	**£0.00m**	**£7.13m**

5.3. **The Authorised Limit** - The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table at 5.5 below demonstrates that during 2009/10 the Council has maintained gross borrowing within its Authorised Limit.

5.4. **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

5.5. **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2009/10
Authorised Limit	**£9.00m**
Maximum gross borrowing position	**£5.00m**
Operational Boundary	**£5.10m**
Average gross borrowing position	**£5.00m**
Financing costs as a proportion of net revenue stream	**(1%)**

6. Economic Background for 2009/10

6.1. Financial markets entered calmer waters in the early stages of the 2009/10 financial year as the worst fears of global depression and bank meltdown subsided. Nevertheless, while economies showed tentative signs of stabilising, a return to a positive growth path was still considered to be a long way off. Indeed, UK GDP data for the first half of 2009 registered its sharpest fall for over 20 years.

6.2. It was not until the summer months that economic performances began to stage a welcome improvement. Fear of a collapse of another leading financial institution lessened markedly and this was reflected in the more 'normal' behaviour of money market rates. That said, banking sectors in most countries were far from trouble free; asset write downs persisted, minor US banks continued to fail and the troubles of a number of building societies continued to make the headlines.

6.3. The UK economy continued to post a mixed performance and it was far from clear how far down the road to recovery it had travelled. The low point of the business cycle was passed during the third quarter of the year but the return to positive growth proved stubborn; for the UK this would not materialise until the fourth quarter of 2009.

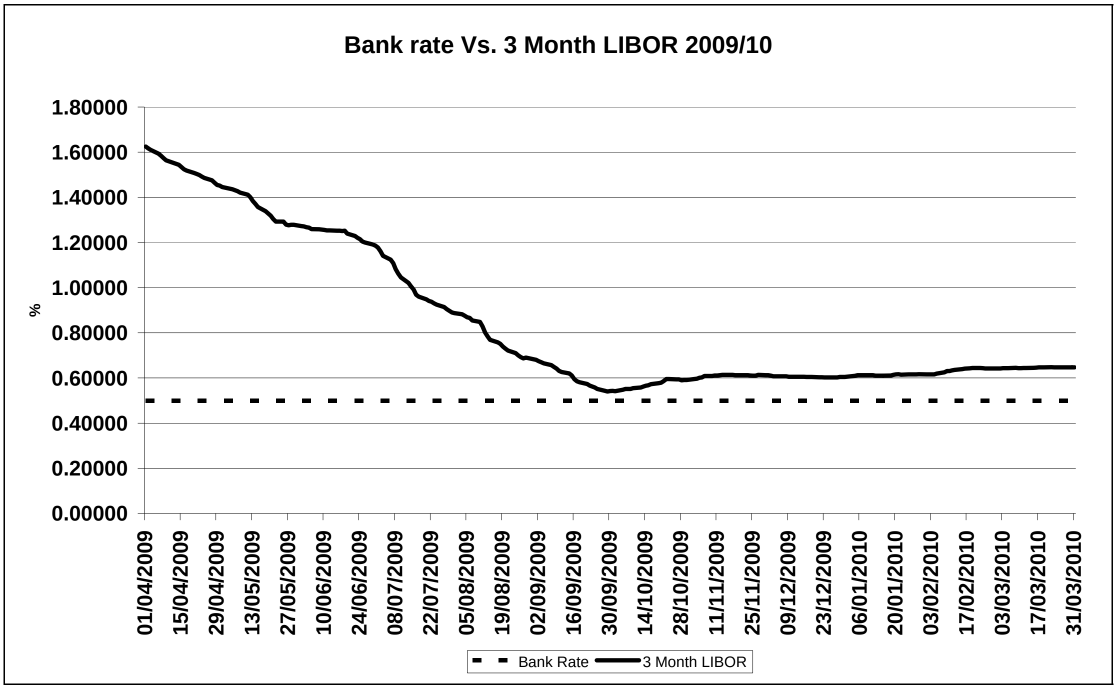
6.4. Industrial production was one of the buoyant areas of the economy, although it was far from consistent. The main area of uncertainty remained consumer spending. This key driver of economic activity was hampered by the household sector's striving to reduce its heavily indebted position. This, along with the continued deterioration in the employment situation and the weakness of earnings growth served as further deterrents to spending.

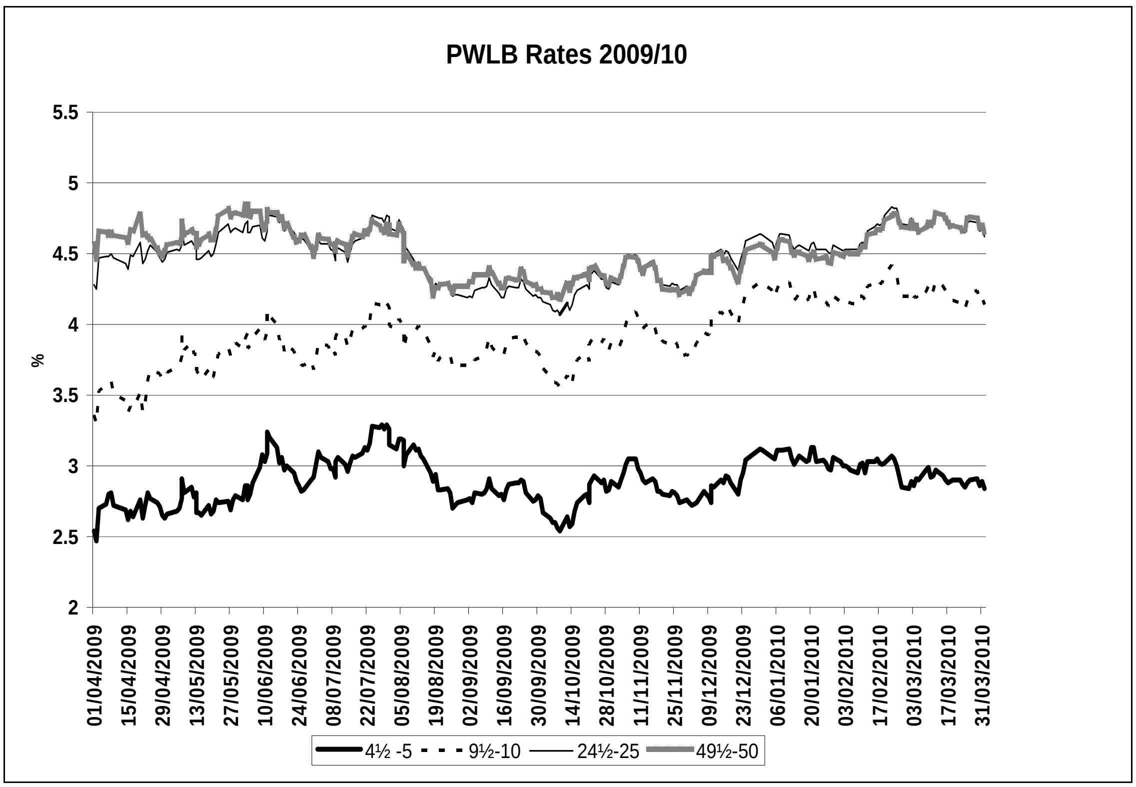
6.5. The bias of Monetary Policy Committee (MPC) decisions remained directed towards policy ease throughout the year. As official interest rates had been reduced to near-zero (0.5% Bank Rate) in March 2009, monetary relaxation took the form of the extension of the Quantitative Easing (QE) programme. The £125bn tranche sanctioned in March was followed by two further boosts, £50bn in August and £25bn in November.

6.6. The accommodative policy approach, coupled with dwindling fears of financial collapse, created an environment in which money market rates eased to yet lower levels. In addition to this, the margin between LIBOR (the rate at which banks are willing to lend money) and LIBID (the rate at which banks are willing to borrow money) rates returned to a more normal position. This was a sign that banks were more comfortable about transacting business between each other but the availability of credit to a wider cross-section of the economy remained problematic through to year-end.

6.7. Long-term interest rates did not suffer from the massive gilt funding requirement created by the surge in the public sector deficit. The QE programme was the principal source of market support. The large-scale purchasing of stock that this element of monetary policy required meant the Bank of England was to absorb virtually all of the year’s supply.

6.8. Nevertheless, the programme was not sufficient to drive yields below the low point seen immediately after the inauguration of the QE programme in March 2009. Long-term rates remained generally erratic, (frequently registering large intra-day movements), but fluctuated within a comparatively narrow range. Investors were happy to take advantage of the support they were receiving from official activity but behaved in a manner that suggested most believed it is only a matter of time before the good fortunes of the market would come to an end. Indeed, yields returned to a rising trend once QE drew to a close in January 2010.





7. The Strategy Agreed for 2009/10

7.1. The strategy provided for 2009/10 expected declining investment balances as reserves were used to support the revenue and capital budgets. Slippage in the Capital Programme resulted in the actual reduction being slightly less than expected. Interest rates were expected to start rising around October 2009 however due to the uncertain economic outlook no increases have yet taken place. The overall result was a shortfall against budgeted investment interest of £100K .

7.2. The 2009/10 and 2010/11 Strategies approved delegated powers, to the Head of Finance and MIS, to restrict the pool of available counterparties to those of higher credit quality than the minimum criteria approved in the Strategy. These temporary restrictions on investment activity and limiting the time period for investments made it increasingly difficult to achieve competitive interest rates. For this reason the 2008/09 Treasury Management Annual report in August 2009 requested agreement to an increase in the lending maximum from £3m to £5m for approved institutions.

8. Actual debt management activity during 2009/10

8.1. **Borrowing** – No loans were drawn to fund the net capital spend. This was in agreement with the budget assumption.

8.2. **Summary of Debt Transactions** – The overall position of the debt activity resulted in no change in the average interest rate, and therefore no net General Fund savings. The Council still has one remaining Market loan in its debt portfolio of £5m. We continually assess the position of this loan with our Treasury Consultants, Butlers, to see whether we are securing the best terms for the Council. At the current time, the advice is to leave this loan in its present form as the cost of redemption is very high.

9. Investment Position

9.1. **Investment Policy –** The Council's investment policy is governed by CLG Guidance, which has been implemented in the annual investment strategy approved by Council on 24th February 2009 and amended by Council on 9th December 2009. The investment activity during the year conformed to the amended approved strategy, and the Council had no liquidity difficulties.

9.2. **Resources –** The Council's longer term cash balances comprise primarily revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and meet the expectations of the budget:

Balance Sheet Resources (£m)	31 March 2009	31 March 2010
Balances	**3.1**	**3.6**
Earmarked reserves	**7.1**	**7.2**
Provisions	**1.5**	**0.3**
Usable capital receipts	**6.7**	**5.4**
Total	**18.4**	**16.5**

9.3. **Investments Held by The Council** - The Council maintained an average balance of £24.89m of internally managed funds. The internally managed funds received an average return of 1.88%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.368%. This compares with a budget assumption of £23m investment balances at 2.34% interest rate.

9.4. The Economic Background for 2009/10 (see Section 6) set out the continuing difficulties in economic conditions during this period. As a result of the deterioration, interest rates remained at historic lows impacting adversely on investment returns. Concerns over the security of financial institutions continued, resulting in a defensive investment position. As a result a more defensive position reduced returns.

10. Performance Indicators set for 2009/10

10.1. The Treasury Management service has set the following performance indicator the result of which is reported at 9.3 above.

- *Investments – Internal returns above the 7 day LIBID rate*

10.2. Security and liquidity benchmarks are being developed and introduced for 2010/11 and will be reported in the mid year monitoring and the annual stewardship reports in December.

11 CONCLUSIONS

11.1 The Council has complied with all of the relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach

12 HOW WILL THE PROPOSALS BE PROJECT MANAGED AND HOW ARE THE RISKS GOING TO BE MANAGED?

12.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities.

Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007

List of Appendices

Appendix A – Investments and Borrowings as at 31 March 2010

Investments and Borrowings at at 31 March 2010

TEMPORARY INVESTMENTS AT 31/03/10

	AMOUNT	PERIOD OF LOAN	VALUE DATE	MATURITY DATE	RATE	BASE RATE
BANK OF SCOTLAND	5,330	CALL			0.75%	
NATWEST	5,000	CALL			0.80%	
RBS Money Market Fund	2,048,000	CALL			0.41%	
NORWICH & PETERBOROUGH B.S.	2,000,000	4 MONTHS	31/12/09	22/04/10	1.20%	
PRINCIPALITY B.S.	2,000,000	3 MONTHS	15/01/10	08/04/10	0.90%	
SKIPTON B.S.	1,500,000	3 MONTHS	15/01/10	08/04/10	0.75%	
SKIPTON B.S.	1,500,000	3 MONTHS	21/01/10	26/04/10	0.77%	
PRINCIPALITY B.S.	2,500,000	3 MONTHS	27/1/10	05/05/10	0.85%	
CHELSEA B.S.	1,000,000	2 MONTHS	04/03/10	14/05/10	0.55%	
SKIPTON B.S.	1,000,000	3 MONTHS	04/03/10	20/05/10	0.65%	
NORWICH & PETERBOROUGH B.S.	1,500,000	4 MONTHS	04/03/10	22/06/10	1.00%	
CHELSEA B.S.	1,000,000	2 MONTHS	15/03/10	20/5/10	0.50%	
CHELSEA B.S.	2,000,000	3 MONTHS	16/3/10	03/06/10	0.55%	
NORWICH & PETERBOROUGH B.S.	1,500,000	1 MONTH	31/3/10	27/4/10	0.55%	
TOTAL	**19,558,330**				0.75%	0.50%

BORROWING AT 31/03/10

	AMOUNT	PERIOD OF LOAN	VALUE DATE	MATURITY DATE	RATE
DEPFA ACS BANK	5,000,000	40 Years	01/02/2002	01-Feb-42	7.55%