REPORT NO: 188/2010

CABINET

21 SEPTEMBER 2010

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

Report of the Director of Corporate Services

STRATEGIC AIM:	**To be a well-managed organisation**		
KEY DECISION	NO	DATE ITEM FIRST APPEARED ON FORWARD PLAN	JUNE 2010

1. PURPOSE OF THE REPORT

1.1 The annual report is a requirement of the Council's reporting procedures. It covers the treasury activity for 2009/10, and the actual Prudential Indicators for 2009/10.

1.2 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.

2. RECOMMENDATIONS

That the Cabinet:

2.1 Approves the actual 2009/10 prudential indicators within the report.

2.2 Notes the treasury management stewardship for 2009/10.

3. REASONS FOR THE RECOMMENDATIONS

3.1 To comply with the regulations set out in 1.2.

4. INTRODUCTION

4.1 This report summarises:

- The capital activity for the year;
- How this activity was financed;
- The impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The reporting of the required prudential indicators;

- The Council's overall treasury position;
- A summary of interest rate movements in the year;
- The detailed debt activity; and
- The detailed investment activity

5. CAPITAL EXPENDITURE AND FINANCING FOR 2009/10

5.1 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); or
- through borrowing if insufficient financing is available, or a decision is taken not to apply resources.

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

	2008/09 Actual £000	**2009/10 Estimate* £000**	**2009/10 Actual £000**
General Fund capital expenditure	6,509	21,347	20,015
HRA capital expenditure	994	983	479
Total Capital Expenditure	**7,503**	**22,330**	**20,494**
Financed by:			
Capital receipts	161	123	27
Capital grants & contributions	4,028	15,846	18,028
Capital reserves	752	752	466
Revenue	254	0	211
Unfinanced Capital Expenditure	**2,308**	**5,609**	**1,762**

* Estimate per Treasury Management Strategy 2009/10 (Report 49/2009)

6. THE COUNCIL'S OVERALL BORROWING NEED

6.1 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for 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.

6.2 The Non-HRA element of the CFR is reduced each year by a statutory revenue charge called the Minimum Revenue Position (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) or depreciation.

6.3 With effect from 1 April 2008 the Communities and Local Government Department (CLG) introduced new MRP Guidance which requires an MRP Policy to be approved by Members. The policy for 2009/10 was approved on 10th February 2009.

6.4 The Council's CFR for the year is shown below, and represents a key prudential indicator.

	2008/09 Actual £000	**2009/10 Estimate £000**	**2009/10 Actual £000**
Opening Non-HRA CFR	*26,924*	27,064	27,958
Opening HRA CFR	*(1,200)*	0	(958)
Total Opening CFR	25,724	27,064	27,000
plus: capital expenditure financed by borrowing	2,308	5,609	1,762
less: MRP	(1,032)	(1,061)	(1,122)
Application of capital receipts	0	0	(4,873)
Closing Non-HRA CFR	*27,958*	*31,612*	*22,767*
Closing HRA CFR	*(958)*	*0*	*0*
Total Closing CFR	**27,000**	**31,612**	**22,767**

6.5 The application of useable capital receipts of £4.873m from the sale of the housing stock resulted in an annual saving of £0.2m to the Council.

7. TREASURY POSITION AT 31 MARCH 2010

7.1 Whilst the Council's gauge of its underlying need to borrow is the CFR, the Director of Corporate Services and the treasury function can manage the Council's actual borrowing position by either:

- Borrowing to the CFR; or
- Choosing to utilise some temporary cash flow funds instead of borrowing (under-borrowing); or
- Borrowing for future increases in the CFR (borrowing in advance of need)

7.2 The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the published statement of accounts by items such as accrued interest.

7.3 During 2009/10 the Director of Corporate Services managed the debt position to maximise the income received from temporary investments and minimise the amount of external borrowing required. The treasury position at the 31 March 2010 compared to the previous year is shown in the following table:

	31 March 2009		31 March 2010	
	Principal	**Average Rate**	**Principal**	**Average rate**
Total long term debt (all fixed rate debt)	£26.386m	4.73%	£21.386m	4.56%
Capital Financing Requirement	£27.000m		£22.767m	
Over/(under) borrowing	(£0.614m)		(1.381m)	
Total investments	(£19.224m)	4.67%	(£20.118m)	0.85%
Net borrowing position	**£7.162m**		**£1.268m**	

7.4 Early in October 2008, the Icelandic banks Landsbanki, Kaupthing and Glitnir collapsed and the UK subsidiaries of the banks, Heritable and Kaupthing Singer and Friedlander went into administration. The authority deposited £1m with Heritable Bank on 15 July 2008 at an interest rate of 6.09%, which should have matured on 15 January 2009.

7.5 The latest creditor progress report issued by the administrators Ernst and Young was in January 2010. This report noted that current projections suggest a best case return to creditors of 79 to 85 pence in the pound.

7.6 To date, the Council has received repayments totaling £0.419m and is expecting further repayments of £0.1m during the current financial year.

8. PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES

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

8.2 **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 2009/10 plus the changes expected to the CFR over 2010/11 and 2011/12. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this indicator.

	31 March 2009 Actual	31 March 2010 Actual
Net borrowing position	£7.162m	£1.268m
CFR	£27.000m	£22.767m

8.3 **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 below demonstrates that during 2009/10 the Council has maintained gross borrowing within its Authorised Limit.

8.4 **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year, and periods where the actual position is either below or above the Boundary are acceptable, subject to the Authorised Limit not being breached.

8.5 **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
Original indicator - Authorised Limit	£34.000m
Original Indicator - Operational Boundary	£31.600m
Maximum gross borrowing position in year	£26.386m
Minimum gross borrowing position in year	£21.386m
Weighted Average gross borrowing position in year	£21.893m
Financing costs as a proportion of net revenue stream	13.64%

9. ECONOMIC BACKGROUND FOR 2009/10 (Provided by Butlers, the Council's Treasury Advisors)

9.1 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.

9.2 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.

9.3 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.

9.4 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.

9.5 The bias of 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 programme. The £125bn tranche sanctioned in March was followed by two further boosts, £50bn in August and £25bn in November.

9.6 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 (London interbank offered rate) and LIBID (London interbank bid rate) 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.

9.7 Long-term interest rates did not suffer from the massive gilt funding requirement created by the surge in the public sector deficit. The Quantitative Easing 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.

10. DEBT MANAGEMENT ACTIVITY DURING 2009/10

10.1 On 7 May 2009 the Council repaid £5m at an average rate of 4.33% with no breakage costs. This has generated an annual saving of £0.216m in interest payable.

11. INVESTMENT POSITION

11.1 The Council's investment policy is governed by CLG Guidance, which has been implemented in the Treasury Management Strategy approved by Council. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

11.2 Investment interest of £0.238m was received during the year, which was slightly less than the £0.250m that was budgeted for and significantly less than has been received in previous years. This is due to the fall in interest rates from an average of 4.67% at 31/3/09 to 0.85% at 31/3/10.

12. REGULATORY FRAMEWORK, RISK AND PERFORMANCE

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 2008/09);

- 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 8 November 2007.

12.2 The Council has complied with all of the above relevant statutory and regulatory requirements which limit 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.

12.3 The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed its treasury position. The Council has continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is minimal risk of volatility of costs in the current debt portfolio as the interest rates are fixed, utilising long-term loans.

13. RISK MANAGEMENT

RISK	IMPACT	COMMENTS
Time	Low	We are required to report by 30 September each year.
Viability	Low	We have complied with the Treasury Management Strategy and the Prudential Code.
Finance	High	This is a critical activity of the Finance Department.
Profile	Low	This is a 'back office' function therefore has a low profile in the public eye.
Equalities and Diversities	Low	There are no particular issues in this area.

Background Papers
Statement of accounts 2009/10
Treasury Management Strategy 2009/10
Cabinet reports as referred.

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