Agenda Item 9

East Northamptonshire Council

Finance Sub Committee - 29 June 2009

Treasury Management Annual Report 2008/09

Summary

The purpose of this report is to advise Members of the Council's Treasury Management activities and performance. This report is a requirement of the CIPFA Code of Practice on Treasury Management and the Council's own constitution.

Attachment(s)

Appendix A - Schedule of fixed term investments made during 2008/09

Appendix B - Schedule of Investments as at 31st March 2009

Appendix C - Bank Base Rate and Money Market Rates

Appendix D - Compliance with Prudential Indicators 2008/09

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1. Background

1.1 Treasury Management in Local Government is governed by the CIPFA Code of Practice on Treasury Management in the Public Services and in this context is the "management of the Council's cash flows, its banking 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". This Council has adopted the Code and complies with its requirements, one of which is the receipt by this Committee of an Annual Strategy Report for the forthcoming financial year and an Annual Review Report after the financial year end.

1.2. The Prudential Capital Finance System came into force on 1 April 2004. The Council determines its capital expenditure and can borrow or use alternative financing methods to finance capital spending provided that capital plans are demonstrably affordable, prudent and sustainable, and options appraisal supports asset management planning. The Prudential Code for Capital Finance in Local Authorities requires indicators to be set – some of which are limits – for a minimum of three forthcoming financial years.

1.3. The Government's Guidance on Local Government Investments in England came into effect on 1 April 2004. The emphasis of the Guidance is on security and liquidity of invested monies. The Council is required to establish an annual investment strategy and to determine 'specified' and 'non specified' investments for use during the year. For 2008/09, these were approved as part of the Annual Treasury Management Strategy approved by Finance Sub-Committee on 11 February 2008.

2. Scope

2.1. This Annual Report covers:

- The Council's investment positions at the beginning and end of the year;
- The forecast for and the prevailing economic background during the year;
- The strategy for borrowing and other financing options for the year and its outturn;
- The annual investment strategy and its outturn;
- Compliance with treasury limits and Prudential Code indicators;
- Other items (e.g. change in treasury advisory and/or banking arrangements).

3. Economic Commentary

3.1. Economic conditions in the UK, Europe and US economies deteriorated rapidly into the worst post-war recession. In the UK house prices slumped by 17.5% in 2008-09. Unemployment rose to 6.7%. The tightening in credit conditions and the economic malaise became entrenched; this rapidly affected growth which fell nearly 3.8% over the 12 month period. The UK was headed for a long and deep recession.

3.2. 2008 saw the worst upheaval in credit and financial markets for some decades. The financial crisis reached boiling point following the collapse of Lehman Brothers in September. It ultimately prompted Governments and central banks to act unilaterally to shore up their financial systems. These included bank bailouts and direct capital injections into banks and financial institutions. Lloyds TSB agreed to acquire HBOS; Cheshire and Derbyshire building societies individually approached Nationwide BS to be acquired by the latter. The government injected significant capital into Royal Bank of Scotland Group (it now owns over 70%) and the Lloyds Banking Group. Financial bailouts and support for banks were replicated in much of Europe and in the US, with increasing pressure from the regulatory authorities for banks to raise their capital ratios to survive the worst of the economic downturn. The Icelandic Government were though unable to provide such support resulting the collapse of it four main banks and the subsequent risk to over £1 billion of UK public investments.

3.3. Bank base rates in the UK and US were rapidly cut to near zero. In the UK the Bank of England cut rates from 5% in April to 0.5% by March 2009. As interest rates had reached terminal levels but were not having much effect in stimulating the economy, the Bank of England initiated its Quantitative Easing (QE) programme in March 2009 under which the Bank would buy back an initial £75bn of gilts over a 3-month period with the purpose of lowering gilt yields and ultimately borrowing costs for the UK corporate sector. This limit was subsequently raised to £125bn.

3.4. The Government's projections for growth in the November Pre-Budget Report were optimistic; it was soon apparent the shortfall in public finances would have to be made good through significant additional borrowing by the Government.

3.5. It was not surprising that money market rates and gilts yields exhibited extreme volatility during the financial year. Money market rates spiked as the banking crisis intensified and confidence crumbled. 3-month Libor, a proxy for the direction of policy rates, climbed to a high of 6.4% in October; this despite markets' forecast that the Bank Rate was set to fall below 3%. Due to the distressed state of the markets, short-term money market rates remained elevated despite the large cuts in the Bank Rate and only began to move down towards the Bank Rate in early 2009 when, following efforts to recapitalise banks, some stability seemed to have returned to the banking and financial sector.

4. Investment Performance and Activity

4.1. The Council's investment income for the year was £1.134m compared to a budget of £1.157. The variance was due to two factors:

- The average amount available for investment throughout the year was £20.15m against a budgeted figures of £21.20m.
- The annual return on investments was 5.60% against a budgeted return of 5.50%.

4.2. The relevant performance target for the treasury function was to achieve 0.25% above the average London Interbank Deposit Rate for 7 day notice deposits (also known as 7 Day LBID uncompounded). The below table shows performance against this benchmark for 2008/09 and preceding years.

	Average Investment	**Rate of Return (gross of fees)**	**Benchmark Return ***	**Cash Equivalent Return Over Benchmark**
2000/01	£20.24m	6.06%	5.67%	£ 78,936
2001/02	£35.00m	5.11%	4.38%	£255,500
2002/03	£29.50m	4.49%	3.65%	£247,800
2003/04	£25.16m	4.59%	3.57%	£256,600
2004/05	£27.66m	4.70%	4.50%	£ 55,320
2005/06	£27.18m	4.76%	4.53%	£ 62,510
2006/07	£26.32m	4.87%	4.82%	£ 13,160
2007/08	£23.47m	5.55%	5.65%	£(23,470)
2008/09	£20.15m	5.60%	3.53%	£417,105

As can be seen from the above table, despite having the lowest average amount available for investment, cash returns over benchmark were at their highest.

4.3. As benchmarking against market rates can be misleading in times of high volatility, we also benchmark our performance against the performance of other local authority treasury teams. This is conducted via a benchmarking club run by the Chartered Institute of Public Finance and Accountancy which has a membership of around 60 Council's. The draft report from this benchmarking exercise shows that our overall return of 5.60% was 0.43% above the average return for the club.

4.4. The high level of performance for this year was as a result of a number of factors, namely:

- The maturity of £4.5m of 5 year deposits in April and August whose return has recently been well below current market rates on offer (although it should be noted that in the first three years they outperformed the market.
- Reaping the benefit of £4m worth of investments made in 2007/08 with maturities of 2 and 3 years.
- Fixed deposits made during the year at rates in excess of 6%.

Appendix A provides a schedule of fixed term deposits made during the year.

4.5. The near collapse of the banking sector in September 2008 in essence put a stop to all fixed terms deposits. Not only did the Council take a cautious approach to whom it would lend money but also the rates that were available did not provide any real value. Instead we took the decision to place all new investments into the various money market funds that were available to the Council. This decision was based on three factors:

- Security – these funds were all AAA rated and therefore offered the lowest level of risk
- Liquidity – we could get back our money without any notice.
- Return – the rates on offer were higher than could be found for fixed rate deposits.

4.6. On 12 November this strategy was changed as result of advice given by our advisors. In their view, there was a potential risks associated with the use of money market funds and as such we should limit our exposure in any one fund to 7.5% of our total portfolio. Previously our limit had been 25%. This resulted in amounts having to be withdrawn from money market funds and placed in instant access deposit accounts paying a significantly lower return.

4.7. Prior to the problems in the financial markets, advantage was taken of the excellent fixed rates available. As can been seen in Appendix A, a number of investments at rates in excess of 6% were made. A number of these investments will continue into the current financial year and will serve to prop up our returns. Details of investments with maturities of more than 1 year are detailed below.

Date of investment	Counterparty	Principal	Rate	Maturity Date
23.5.07	Bank of Ireland	£2.00m	6.43%	24.05.2010
18.10.07	Ulster Bank	£2.00m	6.28%	19.10.2009
13.05.08	Clydesdale Bank	£2.00m	6.65%	13.05.2010
08.08.08	Bank of Scotland	£1.00m	6.50%	10.08.2009

4.8. It should be noted that all investments made during the year were in accordance with the Council's agreed Treasury Management Strategy, Prudential Indicators, Treasury Management Practices and prescribed limits and that those made since September have also taken into consideration advice given by our treasury advisors.

5. Portfolio positions : 01/4/2008 and 31/3/2009

5.1. The Council's treasury position was :

	Balance on 01/4/2008 £m	Average Return %	Maturities/ Withdrawals £m	New Investments £m	Balance on 31/3/2007 £m	Average Return %
INVESTMENTS						
Internally managed investments (short-term)	12.70	5.59	108.3	103.8	8.20	3.47
Longer-term investments						
Deposits with maturities greater than 1 year	4.00	5.38	0.00	1.00	5.00	6.38
TOTAL INVESTMENTS	16.70	5.53	108.3	104.8	13.20	4.52

5.2. The value of maturities/withdrawals and new investments is reflective of our investment strategy from October onwards. Details of our investment holding as at 31 March 2009 can be found at Appendix B.

6. Long-term Borrowing/other Long-term Liabilities: Strategy and Outturn

6.1. The Council was debt free on 1 April 2004 when the new rules around capital investment came into effect. Although there are now no significant advantages in remaining debt-free, the Council's decision was not to borrow to finance its capital spending, relying instead on capital reserves, government grants and other contributions. This position will though change in future years as it will be necessary to borrow to meet the commitments in our current capital programme.

6.2. In 2008/09 capital expenditure was financed as follows :

Source	Amount
Government/Other Grants	£1.296m
Usable Capital Resources	£2.495m
Total	**£3.791m**

7. Compliance with treasury limits and treasury-related Prudential Code indicators.

7.1 The 2003 Prudential Code for Capital Finance in Local Authorities requires the Council to set a number of Prudential Indicators for the financial year and the two succeeding years. Indicators may be revised during the year but need Council approval.

7.2 The Council at its meeting on 3 March 2008 approved the recommended Prudential Indicators for 2008/09. The Indicators are local to this Council and were based on the decisions of full Council regarding the revenue budget and capital programme.

7.3 Appendix D details compliance with indicators for the 2008/09 financial year.

8. Balanced Budget

8.1 In accordance with the Guidance notes issued in 2006 by the Chartered Institute of Public Finance and Accountancy (CIPFA) the Council complied with the Balanced Budget requirement.

9. Recommendation

9.1 That the Annual Treasury report for 2008/09 be noted.

Implications:

Corporate Outcomes or Other Policy/Priority/Strategy

Good Quality of Life	☐	Good Reputation	☐
Good Value for Money	☒	High Quality Service Delivery	☒
Effective Partnership Working	☐	Strong Community Leadership	☐
Effective Management	☒	Knowledge of our Customers and Communities	☐
Employees and Members with the Right Knowledge, Skills and Behaviours			☒
Other:			☐
Decision(s) would be outside the budget or policy framework and require full Council approval			☐

Financial	There are no financial implications at this stage	☐
	There will be financial implications – see paragraph contained to report	☒
	There is provision within existing budget	☐
	Decisions may give rise to additional expenditure at a later date	☐
	Decisions may have potential for income generation	☐
Risk Management	An assessment has been carried out and there are no material risks	☐
	Material risks exist and these are recorded at Risk Register Reference – 106, 107, 218 inherent risk score - Primary residual risk score - Contingency	☒
Staff	There are no additional staffing implications	☒
	Additional staff will be required – see paragraph	☐
Equalities and Human Rights	There will be no impact on equality (race, age, gender, disability, religion/belief, sexual orientation) or human rights implications	☒
	There will be an impact on equality (see categories above) or human rights implications – see paragraph	☐
Legal	Power: Local Government Acts 1989 & 2003	
	Other considerations: CIPFA Code of Practice for Treasury Management The Prudential Code for Capital Finance in Local Authorities	

Background Papers: Various office files, Annual Treasury Strategy Report 2006/07

Person Originating Report: Robert Austin, Head of Resources

Date: 2 June 2009

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(Committee Report Normal Rev. 19)

Schedule of Investments Made in 2008/09

Appendix A

Lent to	Amount	Rate %	From	To
Depfa Bank	£2,000,000.00	5.79000%	10-Apr-08	09-Apr-09
Depfa Bank	£2,000,000.00	5.85000%	14-May-08	13-May-09
Skipton Building Society	£2,000,000.00	6.08000%	06-Jun-08	16-Feb-09
Clydesdale bank	£2,000,000.00	6.65000%	13-May-09	13-May-10
West Bromwich BS	£1,000,000.00	6.28000%	02-Jul-08	16-Mar-09
Bank of Scotland	£1,000,000.00	6.50000%	08-Aug-08	10-Aug-09
Bank of Scotland	£2,000,000.00	6.19000%	19-Aug-08	19-Feb-09
Bank of Scotland	£1,000,000.00	6.20000%	22-Aug-08	23-Mar-09

Summary of Investments as at 31 March 2009

Appendix B

Lent to	Amount	Rate %	From	To
Instant Access Accounts				
Abbey National - Instant Access	2,124,654.29	0.60000		
Alliance & Leicester	15,098.32	0.88000		
Bank of Scotland - Base Plus Deposit Account	6,729.82	0.60000		
Bank of Scotland - Instant Access Deposit Account	4,773.63	0.50000		
Bank of Ireland - Instant Access Account	12,169.32	0.50000		
Std Life Bank - Money Market Fund	1,030,470.53	1.29000		
Henderson Liquid Assets Fund - Money Market Fund	1,030,371.05	1.84000		
Fixed Rate Deposits				
Bank of Scotland	1,000,000.00	6.50000	08 August 2008	10 August 2009
DEPFA Bank	2,000,000.00	5.79000	10 April 2008	09 April 2009
DEPFA Bank	2,000,000.00	5.85000	14 May 2008	13 May 2009
Bank of Ireland	2,000,000.00	6.42500	23 May 2007	24 May 2010
Ulster Bank	2,000,000.00	6.28000	18 October 2007	19 October 2009
Total Investments as at 31st March 2009	**13,224,266.96**			
Forward Rate Deals				
Clydesdale Bank	2,000,000.00	6.65000	13 May 2009	13 May 2010

Appendix C

Bank Base Rate and Money Market Rates

Date	Bank Rate %	7-day LIBID %	1-month LIBID %	3-month LIBID %	6-month LIBID %	12-month LIBID %	2yr Swap Bid %	3-yr Swap Bid %	5-yr Swap Bid %
01-Apr-08	5.250	5.3500	5.7000	5.9400	5.9000	5.7500	5.1210	5.0540	5.0401
30-Apr-08	5.000	5.1000	5.4000	5.7600	5.7600	5.7400	5.3940	5.3610	5.2850
30-May-08	5.000	5.0700	5.3800	5.7900	5.9100	6.0800	5.9670	5.9140	5.7550
30-Jun-08	5.000	5.1000	5.3000	5.8000	6.0800	6.3700	6.2440	6.2190	6.0620
31-Jul-08	5.000	5.0500	5.3000	5.7000	5.8500	6.1000	5.5910	5.5760	5.5010
29-Aug-08	5.000	5.0800	5.3000	5.6900	5.8400	5.9500	5.3380	5.3150	5.2370
30-Sep-08	5.000	5.5000	5.8500	6.1000	6.2000	6.3000	5.3140	5.2540	5.1870
31-Oct-08	4.500	4.2500	5.4500	5.8000	5.7000	5.9400	4.2470	4.3850	4.5970
28-Nov-08	3.000	2.3500	2.8000	3.8500	4.0000	3.5500	3.1310	3.3270	3.6350
31-Dec-08	2.000	1.5000	2.0500	2.0000	2.7100	2.8300	2.5898	2.8610	3.1351
30-Jan-09	1.500	1.1500	1.4500	2.0000	2.1500	2.0500	2.0310	2.3680	2.9490
27-Feb-09	1.000	0.6000	1.2500	1.9000	2.0500	2.2000	2.2670	2.5890	3.1125
31-Mar-09	0.500	0.5500	0.8000	1.4500	1.6200	1.8200	2.0490	2.4550	3.0000
Minimum	**0.500**	0.3500	0.7000	1.4500	1.6200	1.8200	1.9480	2.2660	2.8220
Average	**3.626**	**3.5320**	**4.0121**	**4.4879**	**4.6069**	**4.6858**	**4.2798**	**4.3783**	**4.5055**
Maximum	5.250	5.5000	6.1000	6.2500	6.2500	6.5000	6.5040	6.4970	6.2700
spread	4.750	5.1500	5.4000	4.8000	4.6300	4.6800	4.5560	4.2310	3.4480

Source: Bloomberg

Compliance with Prudential Indicators 2008/09

1 Estimated and Actual Capital Expenditure

1.1. This indicator is set to ensure that the level of proposed investment in capital assets remains within sustainable limits and, in particular, to consider the impact on the Council Tax and in the case of the HRA, housing rent levels.

No.	Prudential Indicator	2008/09 Estimated £m	**2008/09 Outturn £m**
1	**Capital Expenditure**	5.083	**3.808**

2 Estimated and Actual Ratio of Financing Costs to Net Revenue Stream

2.1. This is an indicator of affordability and demonstrates the revenue implications of capital investment decisions by highlighting the proportion of the revenue budget required to meet the borrowing costs associated with capital spending. The financing costs include existing and proposed capital commitments.

No.	Prudential Indicator	2008/09 Estimated %	**2008/09 Outturn %**
3	**Ratio of Financing Costs to Net Revenue Stream**	0	**0**

3 Capital Financing Requirement

3.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the Capital Financing Requirement in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

3.2 The Council met this requirement in FY 2008/09.

No.	Prudential Indicator	31/3/2008 Actual £	31/3/09 Estimated £	**31/3/09 Outturn £**	31/3/10 Estimated £	31/3/11 Estimated £
2	**Capital Financing Requirement**	-0.565	-0.565	**-0.565**	-0.565	-0.565

4 Affordable Borrowing Limit, Authorised Limit and Operational Boundary for External Debt

4.1 Section 3(1) of The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit and should not be breached.

4.2 The Council's Affordable Borrowing Limit (referred to as the Authorised Limit within the Prudential Code) was set at £5m for 2008/09. The Council maintained its total external borrowing and other long-term liabilities well within this limit.

4.3 The Limit has been set on the estimate of the most likely, prudent but not worst case scenario for its total external debt gross of investments with, in addition, sufficient headroom over and above this to allow for unusual cash movements. The limit is consistent with the Council's existing commitments, proposals for capital expenditure and financing and with its approved treasury management policy statement and practices.

4.5 The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit.

4.6 The Operational Boundary was set at £5m.

4.7 There were no breaches to the Authorised Limit and the Operational Boundary during the financial year.

5 Incremental Impact of Capital Investment Decisions

5.1 This is an indicator of affordability that shows the actual impact of capital investment on Council Tax.

No.	**Prudential Indicator**	2008/09
		£
4	**Incremental Impact of Capital Investment Decisions on Council Tax**	7.12

5.2 The above figure is the impact of lost investment income as a result of the use of internal resources to fund capital expenditure. As actual expenditure was below that previously budgeted, the impact is reduced from the original estimate of £9.66.

6 Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure

6.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The exposures are calculated on a net basis, i.e. fixed rate debt net of fixed rate investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

No.	Prudential Indicator	2008/09
		Estimated %
10	**Upper Limit for Fixed Rate Exposure**	0
	Compliance with limits :	Yes
8	**Upper Limit for Variable Rate Exposure**	0
	Compliance with limits :	Yes

7 Maturity Structure of Fixed Rate borrowing

7.1 This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

7.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period in total that is fixed rate.

No.	Maturity structure of fixed rate borrowing	Upper limit £m	Lower limit £m	Compliance with limits set?
12	under 12 months	5	0	Yes
12	12 months and within 24 months	5	0	Yes
12	24 months and within 5 years	5	0	Yes
12	5 years and within 10 years	5	0	Yes
12	10 years and above	5	0	Yes

The Council did not undertake long-term borrowing during the financial year.

8 Total principal sums invested for periods longer than 364 days

8.1 This indicator allows the Council to manage the risk inherent in investments longer than 364 days. The Council is required to set an upper limit for each forward financial year period for the maturity of such investments.

No.	Prudential Indicator	2008/09 £
14	**Limit on Amounts invested in excess of 364 days**	12m
	Compliance with limit set by the Council?	*Yes*

9 **Adoption of the CIPFA Treasury Management Code**

No.	Prudential Indicator	
7	**Has the Council approved the adoption of CIPFA's Code of Treasury Management?**	The Council approved the adoption of the CIPFA Code at its meeting on 29 April 2002.