POLICY & RESOURCES CABINET BOARD

4th September 2008

DIRECTORATE OF FINANCE & CORPORATE SERVICES

REPORT OF THE HEAD OF FINANCIAL SERVICES – HYWEL JENKINS

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PART 1
SECTION A – MATTERS FOR DECISION

ITEM 1

ANNUAL TREASURY REPORT 2007/08 AND AMENDED PRUDENTIAL INDICATORS FOR 2008/09 ONWARDS

Introduction & Background

The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2001 was adopted by Council on 21st March 2002 for adoption from 1st April 2002, and this Authority fully complies with its requirements.

The primary requirements of the Code are as follows:

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

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

- Receipt by Council of an annual treasury management strategy report (including the annual investment strategy report) for the year ahead and an annual review report of the previous year.

- 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.

Treasury management in this context is defined as:

> *"The management of the local authority's 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. "*

This Annual Treasury Report covers:

1. the Authority's treasury position 2007/08;
2. performance measurement;
3. the strategy for 2007/08;
4. the economy including borrowing and investment rates in 2007/08;
5. the borrowing outturn for 2007/08;
6. compliance with treasury limits and Prudential Indicators;
7. investment outturn for 2007/08;
8. debt rescheduling;
9. recommendation

1. TREASURY POSITION 2007/08

The Authority's debt and investment position at the beginning and the end of the year was as follows:

	31/3/08 Principal	**Rate/ Return**	**31/3/07 Principal**	**Rate/ Return**
<u>Borrowing:</u>				
Fixed Rate Funding:				
- PWLB	£157.1m	5.5%	£133.5m	5.8%
- Market LOBOs	£52.5m	3.9%	£37.5m	3.9%
Variable Rate Funding	0		0	
Total External Debt	**£209.6m**	**5.2%**	**£171.0m**	**5.6%**
<u>Lending:</u>				
Total Investments (managed in house)	**£77.2m**	**6.0%**	**£65.0m**	**5.0%**

2. PERFORMANCE MEASUREMENT

One of the key changes in the revision of the Code in 1996 was the formal introduction of performance measurement relating to investments, debt and capital financing activities. Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide.

Section 5 and 7 of this report provides information against which performance can be measured.

3. THE STRATEGY FOR 2007/08

The Treasury Strategy for 2007/08 and into future years was based on the following view of Bank Rate:

- Expected a downward trend from 5.75% to 5.50% in December 2007;
- to be followed by further cuts in Q1 2008 to 5.25%, to 5.00% in Q2 2008 and to 4.75% in Q3 2008;
- then unchanged until an increase in Q4 2009 to 5.0%;
- there was a downside risk to this forecast if inflation concerns subsided and opened the way for the MPC (Monetary Policy Committee) to make further cuts in the Bank Rate.

The effect on interest rates for the UK was therefore expected to be as follows:

- **Shorter-term interest rates** - The "average" City view anticipated that trend growth in the UK, US and EU would eventually lead to a decrease in UK Bank Rate to 4.75% by the end of March 2008.

- **Longer-term interest rates** - The view on longer-term fixed interest rates, 50 years, was that they would remain static around the 4.50% for the whole of the year. The 25 year rate would also remain flat around 4.50%.

The approved strategy put to Council based upon the above forecast, was that the expectation for falling Bank Interest Rate in the future was so strong that the drawing of cheaper, shorter term funding later in the year for 2007/08 borrowing requirement would assist in lowering debt servicing costs. The risk was that leaving longer term borrowing to later years could eventually entail higher longer-term interest costs.

4. THE ECONOMY including Borrowing and Investment Rates in 2007/08

Shorter-term interest rates

The Bank Rate started 2007/08 at 5.25% with expectations that there would be further increases in rates. A further increase in rates to 5.5% duly occurred in May 2007 after CPI inflation had risen to 3% in April 2007. Inflation was expected to remain above the 2% target for the next two years and another rise was delivered in July when Bank Rate rose to 5.75% with the markets fully expecting Bank Rate to increase again. One year interbank was priced at over 6%, GDP growth was continuing to strengthen and the housing market was still robust. The August Inflation Report showed Bank Rate needed to rise to 6% to keep inflation at target in two years time.

August 2007, saw the peak of the interest rate cycle as 'the credit crunch' hit the markets and the global economy. The crunch originated in the US through the sub-prime housing market, however world wide investors, particularly banks, had invested in packages of sub-prime loans, attracted by the higher yields offered. Fears arose that a large number of these investments would turn out to be worthless and this in turn would lead to bankruptcies amongst the banking sector. As a result of these fears, banks became increasingly reluctant to lend to each other forcing many countries central banks to inject liquidity into the Markets.

In September 2007, the UK Government announced a guarantee for deposits in Northern Rock, a UK bank severely affected by the drying up of wholesale money market funding. In November 2007 the price of oil rose to record levels and UK interest rates remained unchanged because of concerns about the inflation outlook despite CPI dropping to 1.8% in September. Credit crunch concerns prompted the MPC to cut rates further to 5.50% in December 2007.

2008 started with fears about the global economy. Stock markets fell sharply and government bond yields also fell prompting further reductions in world central bank interest rates. In February 2008, the MPC reduced the UK Bank Rate to 5.25% and the nationalization of Northern Rock was announced.

The 2007/08 financial year ended with the money markets anxious and nervous and 3 month cash 0.75% above bank rate. The dislocation between the central banks of the world interest rates and market interest rates, which had persisted since the summer of 2007 as a result of the credit crunch remained.

Longer-term interest rates

The PWLB 45-50 year rate started the year at 4.45 and fell to a low of 4.38% in March 2008. The high point, of which there were several, for 45-50 year was 4.90% before finishing the year at 4.42%. The volatility in yields was a direct reflection of the massive turnaround in interest rate sentiment brought about by the sub-prime crisis in the US.

A radical change to the PWLB rate structure was introduced by the DMO (Debt Management Office) on 1st November when they moved to single basis point moves in their rates and, at the same time, introduced a separate repayment rate at a level significantly below the rate at which they would lend new money. This reduced the opportunity for Local Authorities to benefit from Debt Rescheduling arrangements.

5. BORROWING OUTTURN FOR 2007/08

The following borrowing was arranged in 2007/08:

Date	Lender	Ref.	Amount	Rate	Period	Type
14 Nov 07	Dexia Credit Local	LOBO4	£15.0m	4.01%	70.0 years	70yr/2yr fixed LOBO with semi-annual calls maturity 14 Nov 2077
20 Mar 08	PWLB	494500	£ 8.0m	3.83%	2.0 years	Fixed maturity loan to 01 Jan 2010
Total			**£23.0m**			

As comparative performance indicators, average PWLB maturity loan interest rates for 2007/08 were:

1 year	5.18%
9.5 - 10 year	5.07%*
25 - 30 year	4.74%*
49.5 - 50 year	4.60%*

* due to the change in banding of PWLB rates as from 1.11.07, some adjustment has had to be used to calculate some average figures.

Debt Performance
As highlighted in section 3 above the average debt portfolio interest rate has reduced during the year from 5.6% to **5.2%.** The approach during the year was:

- To draw fixed rate debt, taking advantage of low PWLB short term rates, and
- To borrow variable long term funding from the market, fixing the initial 2 year period, as these rates were generally lower.

Rates were not expected to rise significantly within the next 2 years when the loans may need to be refinanced.

6. COMPLIANCE WITH TREASURY LIMITS

During the financial year the Authority operated within the treasury limits and Prudential Indicators set out in the Authority's annual Treasury Strategy Statement.

The outturn for the Prudential Indicators is shown in Appendix 1.

Members should note that as a result of receiving the Welsh Assembly Government Approval to extend the repayment of the Capitalisation Directive for Job Evaluation Compensation of £8.2m from 10 years to 20 years, it has been necessary to recalculate and provide some new prudential indicators for 2008/09 onwards e.g.

- A1.2 Capital Financing Requirement
- A2.1 Operational Boundary
- A2.2 Authorised Limit
- A3.2 Interest Rate Exposure

7. INVESTMENT OUTTURN FOR 2007/08

Internally Managed Investments
The Authority manages all its investments in-house and invests with institutions which satisfy the Authority's approved criteria. The Authority usually invests for a range of periods from overnight to 364 days, although investments of up to 5 years are permitted. All investments are dependent on the Authority's cash flows, its interest rate view and the interest rates on offer.

Investment Strategy
At the start of 2007/08 the forecast was that interest rates would increase due to concerns around rising inflationary pressures. These concerns grew further and correspondingly caused the forecast for interest rates to rise in order to counter this problem. The Bank of England duly reacted to the inflation threat with two 0.25% increases in Bank Rate by August with market expectation that one further increase to 6% would be required.

From the summer of 2007, markets became increasingly dislocated from the fundamentals of global economies as the credit crunch deepened. The authority took advantage of the rising interest rates caused by the turmoil in the financial markets by investing in the one year period as previous investments matured. Balances in call accounts were increased as the rates offered were often higher than short term rates.

Investment Outturn for 2007/08
Detailed below is the result of the investment strategy undertaken by the Authority:

	Average Investment	**External Interest**	**Rate of Return**	**Benchmark Return**
Internally Managed	£80.9m	£4.9m	**6.00%**	5.92%

Benchmarks for 2007-08:

- LIBID (London Inter Bank Bid Rate)
  7 day LIBID uncompounded 5.58%
  3 Month LIBID uncompounded 5.92%

- Bank Rates in effect during 2007/08:
  11jan07-09may07 5.25%
  10may07-04jul07 5.50%
  05jul07-05dec07 5.75%
  06dec07-06feb08 5.50%
  07feb08-09apr08 5.00%

  Weighted average bank rate for year 5.54%

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

8. DEBT RESCHEDULING

Some rescheduling opportunities were available in 2007-08 until November when the PWLB radically changed the structure of their rates. The PWLB changes introduced two interest rates, one for new loans and a higher rate for the repayment of existing loans. Daily movements of 1 basis point (0.01%) instead of the previous 5bp (0.05%) and increased period ranges were also introduced. These changes effectively prevented the Authority from restructuring the portfolio into new PWLB borrowing.

LOBO structures offered levels of around 4.25% and even sub 4% during this period of unprecedented turmoil in the markets.

As a result of the PWLB changes, no debt restructuring was undertaken by the authority during the year. Instead the additional borrowing totalling £23m from both the PWLB and Market at historically low interest rates were made, increasing the authorities Capital Financing Requirement close to its operational limit, externalising internal borrowing and reducing overall interest charges.

9. RECOMMENDATION

It is recommended that Members:

a) Note the content of this report;
b) Approve the updated Prudential Indicators for 2008/09 to 2010/11 as set out in Appendix 1.

10. REASON FOR PROPOSED DECISION

To approve, in line with Statutory Requirements, the Annual Treasury Report for the Council.

List of Background Papers
TM Closing 2007/08

Wards Affected
All

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COMPLIANCE STATEMENT

ANNUAL TREASURY REPORT 2007/08 AND AMENDED PRUDENTIAL INDICATORS FOR 2008/09 ONWARDS

Implementation of Decision

The decision is proposed for implementation after the three day call in period.

Sustainability Appraisal

Community Plan Impacts		
Economic Prosperity	-	No impact
Education & Lifelong Learning	-	No impact
Better Health & Well Being	-	No impact
Environment & Transport	-	No impact
Crime & Disorder	-	No impact

Other Impacts		
Welsh Language	-	No impact
Sustainable Development	-	Positive
Equalities	-	No impact
Social Inclusion	-	No impact

Consultation

There has been no requirement under the Constitution for external consultation on this item.

PRUDENTIAL INDICATORS FOR PERIOD 2007/08 TO 2010/11

A1. Capital Expenditure Indicators

The Authority was granted an extended repayment period from 10 to 20 years by the Welsh Assembly Government for its Capitalisation Directive for Job Evaluation Compensation Payments. An adjustment has been made to update some of the future year Prudential Indicator Estimates e.g. A1.2, A2, A3.

A1.1 Estimates of Capital Expenditure

'The local authority will make reasonable estimates of the total capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years.'

	2007/08 Revised £'000	2007/08 Actual £'000	2008/09 Estimate £'000	2009/10 Estimate £'000	2010/11 Estimate £'000
General Fund	51,731	48,375	48,045	21,206	18,102
HRA	8,300	7,920	9,982	6,904	6,200
TOTAL	**60,031**	**56,295**	**58,027**	**28,110**	**24,302**

* The Authority expects to supplement its Capital Expenditure Programme in 2009/10 and beyond through additional external grant funding of projects. These figures will be updated in future years.

A1.2 Estimates of Capital Financing Requirement

The term Capital Financing Requirement represents the projected total amount of borrowing needed to fund Capital Expenditure. The sums involved are shown below:

	2007/08 Revised £'000	2007/08 Actual £'000	2008/09 Estimate £'000	2009/10 Estimate £'000	2010/11 Estimate £'000
General Fund	172,352	172,534	177,446	182,493	188,673
HRA	38,024	37,927	36,126	34,258	32,420
TOTAL	**210,376**	**210,461**	**213,572**	**216,751**	**221,093**

The Capital Financing Requirement Indicators of £210.376m has been exceeded in 2007/08 by £85,000. This has occurred because of an extended repayment period from 10 years to 20 years as approved by the Welsh Assembly Government through the Capitalisation Directive for Job Evaluation Compensation Payments.

A2. External Debt Indicators

A2.1 Operational Boundary

The local authority will set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt. The operational boundary should be based on the Authority's estimate of most likely i.e. prudent, but not worst case scenario.

	2007/08 Revised £'000	2007/08 Actual £'000	2008/09 Estimate £'000	2009/10 Estimate £'000	2010/11 Estimate £'000
Operational Boundary	244,935	235,138	250,603	256,254	263,068

A2.2 Authorised Limit

The local authority will set for the forthcoming financial year and the following two financial years an authorised limit for its external debt.

	2007/08 Revised £'000	2007/08 Actual £'000	2008/09 Estimate £'000	2009/10 Estimate £'000	2010/11 Estimate £'000
Authorised Limit	264,935	243,828	270,603	276,254	283,068

A3. Treasury Management Indicators

The following Treasury Management Indicators are required:-

A3.1 The Council adopted the CIPFA Code of Practice for Treasury Management in the Public Services in 2002. This indicator reaffirms the Authority's commitment to comply with the Code of Practice.

A3.2 The following limits be established to administer interest rate exposure for the next 3 years.

	2007/08 Actual £'000	2008/09 to 2010/11 Estimate £'000
Upper Limit on Fixed Interest Rate Exposure	154,235	193,068
Lower Limit on Fixed Interest Rate Exposure	0	0
Upper Limit on Variable Interest Rate Exposure	77,118	96,534
Lower Limit on Variable Interest Rate Exposure	0	0

The above limits will be measured upon the net principal invested method. This method takes account of total borrowing outstanding less principal sums invested.

A3.3 The Borrowing Maturity structure will be:

	Upper Limit %	Lower Limit %	2007/08 Actual %
Under 12 months	15	0	1
12 months to 2 years	15	0	4
2 to 5 years	40	0	2
5 to 10 years	60	0	6
10 years +	100	15	87

The total sums invested for more than 364 days will be restricted to a maximum of £25m.

A4. Affordability Indicators

These indicators consider the estimated impact of capital financing costs on the net budget, taxpayers and housing tenants of the authority.

	2007/08 Revised	2007/08 Actual	2008/09 Estimate	2009/10 Estimate	2010/11 Estimate
Estimated ratio of financing cost to net revenue stream:					
- for General Fund	7.03%	6.44%	6.82%	6.96%	6.76%
- for HRA	11.70%	11.70%	10.26%	9.80%	2.63%
Estimate of incremental impact of capital investment decisions on:					
- Council Tax	NA	£20.88	£8.25	£16.55	£0.87
- Housing Rents (No borrowing)	0	0	0	0	0

PART 1
SECTION B – MATTERS FOR INFORMATION

ITEM 2

TREASURY MANAGEMENT

1. Purpose of Report

This report sets out treasury management action and information since the previous report.

2. Long Term Borrowing

No long term borrowing has been arranged since the previous report.

3. Rates of Interest

3.1. The Bank Rate:

10 May 2007 to 4 July 2007	5.50%
5 July 2007 to 5 December 2007	5.75%
6 December 2007 to 06 February 2008	5.50%
07 February 2008 to 09 April 2008	5.25%
10 April 2008 to date	5.00%

3.2 Public Works Loans Board

Examples of Public Works Loan Board new loan fixed interest rates in effect on 21st August 2008:

	Equal Instalments of Principal		**Annuity**		**Maturity**	
	Current 21Aug08	**Previous 02Jul08**	**Current 21Aug08**	**Previous 02Jul08**	**Current 21Aug08**	**Previous 02Jul08**
	%	**%**	**%**	**%**	**%**	**%**
5 to 5.5 years	4.67	5.31	4.67	5.31	4.63	5.34
10 to 10.5 years	4.63	5.34	4.64	5.34	4.77	5.36
15 to 15.5 years	4.69	5.36	4.72	5.36	4.86	5.32
20 to 20.5 years	4.77	5.36	4.82	5.36	4.82	5.20
25 to 25.5 years	4.83	5.35	4.86	5.31	4.70	5.04
35 to 35.5 years	4.85	5.26	4.77	5.12	4.56	4.84
49.5 to 50 years	4.70	5.04	4.45	4.83	4.45	4.64

4. Treasury Management Practices

Breach of Counterparty Limit. Treasury Management Practices (TMP1) limits the total investment with any one counterparty to £10m.

However, total investments with Bank of Scotland exceeded this limit on two occasions during August 2008 as follows:

From	To	Days	Deposits		Total Deposit	Limit Exceeded
			Fixed	Call		
11Aug08	13Aug08	2	£5.00m	£10.00m	£15.00m	£5.00m
20Aug08	22Aug08	2	£5.00m	£7.58m	£12.58m	£2.58m

These were short term measures to facilitate immediate cashflow requirements.

List of Background Papers
PWLB Interest Rate Notice 165/08
TM call account balances

Wards Affected
All

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