Agenda Item	

REPORT FOR DECISION

MEETING:	**RESOURCE AND PERFORMANCE SCRUTINY COMMISSION** **THE EXECUTIVE**
DATE:	**26 August 2008** **3 September 2008**
SUBJECT:	**TREASURY MANAGEMENT ANNUAL REPORT 2007/08**
REPORT FROM:	**EXECUTIVE MEMBER FOR RESOURCE**
CONTACT OFFICER:	**Mike Owen – Director of Finance and E-Government**
TYPE OF DECISION:	**Council**
REPORT STATUS:	**For Publication**

PURPOSE/SUMMARY:

The Council undertakes Treasury Management activities in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice, which requires that the Council receives an annual strategy report by 31 March for the year ahead and an annual review report of the previous year by 30 September. This report is the review of Treasury Management activities during 2007/08.

The key point for Members to note from the Annual Report are:

- Advantage was taken of rescheduling opportunities to lower the average interest rate of the loan portfolio. Rescheduling of loans in 2007/08 and the full year effect of earlier rescheduling resulted in lower interest costs and led to a decrease in the average borrowing rate during the year to 5.40% in 2007/08 compared to 5.50% in 2006/07.

- The borrowing level fell slightly during the year from £113.141m to £112.854m due to the natural maturity of loans. New borrowing of £10 million originally scheduled for 2007/08 was delayed until 2008/09 to take advantage of more favourable interest rates. There was a slight increase in the investment balance from £35.350m to £36.294m.

- There was an increase in the rate of return on investments at 5.83% in 2007/08 compared to 4.92% in 2006/07. The rise was due to increased interest rates in 2007/08 where the bank base rate averaged 5.54% for the year.

- The average rate of return on investments was greater than the national benchmark by 0.25% yielding an additional £132,000 in income.

OPTIONS AND RECOMMENDED OPTION:

It is recommended that

- In accordance with the CIPFA Code, the Annual Report be noted

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IMPLICATIONS -

Financial Implications and Risk Considerations	See Statement of Director of Finance and E-Government below

Corporate Aims/Policy Framework:

Do the proposals accord with the Policy Framework? Yes.

Treasury Management (in the form of the Cost of Borrowing) is a key element of the Medium-Term Financial Strategy and as such underpins all of the Council's Aims. The contents of this report are in accordance with the policy and budget framework.

Are there any legal implications?	Yes. The report meets the requirements of the CIPFA Treasury Management Code of Practice which is considered best practice.
Considered by Monitoring Officer:	Yes. The presentation of an annual report on Treasury Management by 30th September of the following financial year is a requirement of the Council's Financial Regulations 5.7 and of the Council's Financial Procedure Rules and Budget and Policy framework, relating to Risk Management and Control of Resources: Treasury Management.
Statement by Director of Finance and E-Government:	This report provides information on the Council's debt, borrowing, and investment activity for the financial year ending on 31st March 2008 and conforms with the CIPFA Code of Practice for Treasury Management. The successful management of the Council's borrowing and investments is central to the Council's financial strategy, both in the short term and in ensuring a balanced debt profile over the next 25 to 60 years.

	The strategy set for 2007/08 required that external borrowing would only be taken if long term rates remained favourable at a target rate of 4.25%. Long-term debt decreased during the year, £112.854m in 2007/08 compared to £113.141m in 2006/07. The average borrowing rate fell due to rescheduling of loans. Investments at 31 March 2008 stood at £36.294m, compared to £35.350m in the previous year. The average rate of return on investments was 5.83% in 2007/08 compared to 4.92% in 2006/07.
Staffing/ICT/Property:	There are no direct staffing, ICT or property implications however treasury management plays a part in the budget setting process, in that the achievement of low borrowing costs and high investment returns provide opportunities for increased investment / spending in other areas.
Wards Affected:	All
Scrutiny Interest:	Resource and Performance Scrutiny Commission

TRACKING/PROCESS **DIRECTOR:** Mike Owen

Chief Executive/ Management Board	Executive Member/ Chair	Ward Members	Partners
Yes	**Yes**		
Scrutiny Commission	Executive	Committee	Council
Yes	**Yes**		**Yes**

1.0 BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management 2001 was most recently adopted by this Council on 22 February 2006 and this Council fully complies with its requirements. The primary requirements of the Code are the: -

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 Council of an annual strategy report for the year ahead and an annual review report of the previous year.

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.

1.2 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. "

1.3 This **annual treasury report** covers:

- the Council's current treasury position;
- overview of the 2007/08 strategy;
- economic review for 2007/08;
- borrowing outturn for 2007/08;
- investment outturn for 2007/08;
- compliance with treasury limits and Prudential Indicators.

2.0 CURRENT TREASURY POSITION

2.1 The Council's debt and investment position at nominal values for the beginning and the end of 2007/08 was as follows:

	31st March 2007 Principal £'000	**Average Interest Rate**	**31st March 2008 Principal £'000**	**Average Interest Rate**
Fixed Rate Funding:				
- PWLB	65,309		65,309	
- Market	39,000		39,000	
- Local Bonds	3		3	
Variable Rate Funding:				
- PWLB	0		0	
- Market	0		0	
Bury MBC Debt	104,312		104,312	
Airport Debt	8,829		8,542	
Total Debt	**113,141**	**5.50%**	**112,854**	**5.40%**
Total Investments	**35,350**	**4.92%**	**36,294**	**5.83%**

3.0 THE STRATEGY FOR 2007/08

3.1 The strategy for 2007/08 was to take advantage of historically low rated long term external debt for capital financing purposes at around 4.25% and invest at rates which are expected to be around 5.25% in accordance with cashflow needs. Overall costs would be maintained at a minimum.

3.2 During 2007/08 the forecast for the borrowing strategy was that long dated borrowings should be taken at any time in the financial year when the 50 year PWLB rate fell back to the central forecast rate of 4.25%. It was predicted that the 50 year rate would be lower than the shorter maturities.

3.3 The interest rate expectations for 2007/08 resulted in the authority's strategy being:

- To draw longer term fixed rate debt to take advantage of low long term rates and reduce exposure to fluctuations in short term interest rates.

- To reschedule debt when favourable rates presented themselves, to generate cash savings, minimise finance costs and enhance the balance of the long term maturity profile.

3.4 The economic review below shows that during the year long term PWLB fixed rates fluctuated and there were times when favourable rates were available to borrow long term and repay debt early.

4.0 ECONOMIC REVIEW FOR 2007/08

4.1 **Shorter-term interest rates** – Bank Rate started 2007/08 at 5.25% with expectations that there would be further increases in rates. This was reflected in a positive inter-bank money market curve. A further increase in rates to 5.5% duly occurred on 10th May 2007 but not before the Governor of the Bank of England had written a letter to the Chancellor in April explaining why CPI had risen to 1% or more above the official CPI inflation target of 2%. The Bank of England's Inflation Report issued in May showed inflation would be above target at the two year horizon. Another rise was delivered on 5th July when Bank Rate rose to 5.75% and the markets, including Sector, fully expected Bank Rate to increase again. One year inter-bank 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.

4.2 August 2007 was the peak of interest rates as what has become known as 'the credit crunch' hit the markets and the global economy. The crunch originated in the US through the sub-prime housing market. Although originating in the US, 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, and the ensuing reluctance of banks to lend to each other, the Federal Reserve Bank injected $38bn of liquidity into the markets on 9th August. The European Central Bank followed suit but the Bank of England stood on the sidelines only making cash available at a penal rate of 1% above Bank Rate. On 17th August the Federal Reserve cut interest rates by 50 bp to 5.25%. On 20th August Sector revised its interest rate view to reflect a downside risk to its forecast. The dislocation in the markets continued throughout the summer until on 14th September it was announced that the Bank of England had provided billions of pounds of financial support to Northern Rock. Northern Rock had been affected by the drying up of the wholesale money markets which provided 80% of its funding. On 17th September the Chancellor announced a Government guarantee for all deposits held at the stricken bank. A day later the Federal Reserve cut US rates by a further 50bp although oil rose to $80 a barrel and continued to climb reaching a peak, briefly, of $100pb in November. On 24th September Sector revised its interest rate forecast with 5.75% now the peak in rates. At its October meeting the MPC declined to cut Bank Rate, being concerned about the inflation outlook. UK data continued to be robust during the autumn although CPI dropped to 1.8% in September. 3 month LIBID still remained well above Bank Rate. On 31st October the Federal Reserve cut rates yet again to 4.50% and the following day they added $41bn of reserves in an attempt to free up the markets. The MPC eventually cut Bank Rate on 6th December to 5.50% as concerns about the economy and the credit crunch mounted. On 10th December both UBS and Capital Economics revised their interest rate forecasts down sharply. A day later the Federal Reserve cut rates again, this time by 25 bp.

4.3 2008 was ushered in with major fears about the global economy. Stock markets fell sharply and government bond yields fell. On 22nd January the Federal Reserve cut rates, this time by a massive 0.75bp to 3.5%, and once more on 30th January to 3%. In February, the MPC cut Bank Rate by 25 bp to 5.25%. On 18th February it was announced that the Government would nationalize Northern Rock. In late February and March the markets seized up again, forcing concerted liquidity intervention by the world's central banks, initially to little avail. The UK budget brought increased debt issuance, but little else, pushing gilt yields up sharply at the front end and driving PWLB rates up. On 14th March US investment bank Bear Stearns had to be bailed out by the Federal Reserve, culminating in a takeover by JP Morgan. The year ended with the money markets anxious and nervous and 3 month cash 75bp above bank rate.

4.4 **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 on 1st November when they moved to single basis point moves in their rates and introduced a separate repayment rate at the same time, at a level significantly below the rate at which they would lend new money.

5.0 BORROWING OUTTURN FOR 2007/08

5.1 The capital financing requirement (CFR) for 2007/08 highlighted the need to borrow £9.3 million to fund capital investment for the year. The Council's total borrowing is determined by the cumulative CFR. When the cumulative CFR is compared to outstanding debt the difference is the amount of headroom still available to borrow. At the end of 2007/08 debt stood at £112.9m and the CFR at £141.4m. Therefore, in theory, borrowing of £28.5m could be taken to finance past and present capital expenditure. However it was never the Council's intention to raise this level of debt, being mindful of the revenue implications. New borrowing of £10 million originally scheduled for 2007/08 took place in early 2008/09 to take advantage of favourable interest rates.

5.2 In accordance with the 2007/08 strategy rates were monitored to take advantage of the lowest possible rates.

5.3 During the year a PWLB loan was rescheduled. A loan for £4m costing 4.6% in interest was repaid and a new loan of £4m costing 4.5% was taken out in its place. The loan repayment also earned a discount of £0.165m.

5.4 An analysis of movements on loans during the year is shown below:

	Balance at	**Loans**	**Loans**	**Balance**
	31.3.07	**Raised**	**Repaid**	**31.03.07**
	£000s	**£000s**	**£000s**	**£000s**
PWLB	65,309	4,000	4,000	65,309
Market	39,000	0	0	39,000
Other loans	3	0	0	3
Bury MBC Debt	**104,312**	**4,000**	**4,000**	**104,312**
Airport PWLB Debt	**8,829**	**0**	**287**	**8,542**
Total Debt	**113,141**	**4,000**	**4,287**	**112,854**

5.5 The approach during 2007/08 was to take advantage of rates when they were at their lowest and identify debt rescheduling opportunities.

5.6 The active monitoring of the debt portfolio, the rescheduling of loans and the taking of new loans at historically low rates has decreased the average Interest rate on the debt held over time:

Year	01/02	02/03	03/04	04/05	05/06	06/07	07/08
Average Interest Rate on Debt	6.38%	5.88%	5.74%	6.21%	5.85%	5.50%	5.40%

5.7 The average interest rate falls over time due to rescheduling of loans to lower interest rates and the borrowing of new loans at historically low levels. The average interest rate on debt increased between 2003/04 and 2004/05 due to £11m of debt at an average of 3.95% being repaid at the end of 2003/04. The rise in the average rate is seen so acutely due to the large repayment of debt occurring at the end of 2003/04 and the low rate of that debt no longer contributing to the average interest rate.

5.8 The Council's policy on the fall out of debt has been to establish a debt profile where the amount of debt due to be refinanced each year is stable and large scale financing in any one year avoided. Market LOBO (Lenders Option Borrower's Option loans) loans are recorded in accordance with the regulations set down in the Prudential Code which states "the maturity of borrowing should be determined by reference to the earliest date on which the lender can require payment".

6.0 INVESTMENT OUTTURN FOR 2007/08

6.1 The Council manages its investments in-house with the overall objective to balance risk with return and the overriding consideration being given to the security of the available funds.

6.2 Surplus funds have been invested with institutions listed in the Council's approved lending list and also with those institutions which meet the Council's stated credit criteria of "specified investments" as detailed in the 2006/07 Investment Strategy in accordance with the DCLG's Guidance on Local Government Investments issued in March 2004 as a result of the Local Government Act 2003.

6.3 Institutions in which investments were made did not have any difficulty in repaying investments and interest in full during the year.

6.4 The investment strategy for 2007/08 approved by Council in February 2007 forecast the bank rate to be on a falling trend from 5.50% to reach 5.00% by the end of the financial year. Actual bank rate, however, rose from 5.50% to 5.75% in July 2007 and only fell to 5.25% in February 2008.

6.5 The strategy also recognised that the borrowing requirement would match the capital expenditure requirement and therefore the Council's funds would be mainly cash-flow driven. The Council would seek to utilise it business reserve accounts and short dated deposits in order to benefit from the compounding of interest.

6.6 Detailed below is the result of the investment strategy undertaken by the Council.

	Average Total Value of Investments	Rate of Return	Benchmark Return *
Internally Managed	£52,642,239	5.83%	5.58%

* the benchmark return is the average 7-day LIBID rate (uncompounded) sourced from the Financial Times

6.7 Investments at 31 March 2008 stood at £36.29m (£35.35m at 31 March 2007), whilst the average for the year was £52.64m (£39.31m at 31 March 2007). The increase in the weighted average investments from 2006/07 to 2007/08 reflects the strategy to borrow in accordance with the capital financing requirement. However there was some recorded slippage in the capital programme which results in surplus funds. Therefore the weighted average balance for the year has risen.

6.8 Total interest earned in the financial year was £2.988 million compared to £1.928 million in 2006/07 due to the increase in interest rates and rise in the weighted average investments.

7.0 COMPLIANCE WITH TREASURY LIMITS

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

8.0 CONCLUSION

8.1 It is recommended that Members note the treasury management activity that has occurred during the financial year 2007/08.

Cllr Peter Redstone
Executive Member for Resource

List of Background Papers:-
Unaudited Final Accounts Bury MBC 2007/08
CIPFA Treasury Management Code of Practice in the Public Services
CIPFA The Prudential Code for Capital Finance in Local Authorities
Financial markets and economic briefing papers

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The key objectives of the Prudential Indicators are to ensure that the Council's capital investment plans and treasury management decisions are affordable, prudent and sustainable or in exceptional cases to highlight if this is not achievable. The prudential indicators for 2007/08 were not breached and were kept within their limits.

The table below shows the Prudential Indicators for 2007/08.

CAPITAL EXPENDITURE	**Original Budget 2007/08**	**Actual Outturn 2007/08**	**variance**
	£'000	**£'000**	
Estimate of Capital Expenditure			
Non-HRA	31,003	23,441	
HRA	12,670	12,095	
TOTAL	**43,673**	**35,536**	(18.63%)
Estimate of Capital Financing Requirement (CFR)			
Non-HRA	122,265	110,773	
HRA	30,253	30,577	
	152,518	**141,350**	(7.32%)

AFFORDABILITY	**Original Budget 2007/08**	**Actual Outturn 2007/08**	**Variance**
Estimate of incremental impact of capital investment decisions			
Increase in council tax (band D, per annum)	£32.34	£8.51	
Increase in housing rent per week	£0.00	£0.00	
Ratio of Financing Costs to net revenue stream			
Non-HRA	7.28%	5.65%	(22.39%)
HRA	4.52%	4.57%	0.44%
Net External Borrowing only to support the CFR in Medium Term	**£'000**	**£'000**	
Net External borrowing over medium term	156,010	156,010	
Total CFR over Medium Term	163,361	163,361	
Net External Borrowing < Total CFR	TRUE	TRUE	

EXTERNAL DEBT	**Original Budget 2007/08**	**Actual Outturn 2007/08**	**variance**
	£'000	**£'000**	
Actual External Debt		112,854	
Authorised limit of external debt			

Borrowing	203,200	203,200	
other long term liabilities	9,400	9,400	
TOTAL	212,600	212,600	0.00%
Operational boundary			
Borrowing	168,600	168,600	
other long term liabilities	9,400	9,400	
TOTAL	178,000	178,000	0.00%

TREASURY MANAGEMENT	**Original Budget 2007/08**	**Actual Outturn 2007/08**	**variance**
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	140%	140%	0%
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investment	-40%	-40%	0%
Upper limit for total principal sums invested for 364 days	£10 m	£10 m	
Maturity structure of fixed rate borrowing 2007/08	Upper/lower limit	Actual	
Under 12 months	10% - 0%	0.3%	
12 months and within 24 months	35% - 0%	7.0%	
24 months and within 5 years	40% - 0%	8.5%	
5 years and within 10 years	50% - 0%	9.3%	
10 years and above	90% - 30%	74.9%	

The prudential indicators of affordability listed above address the revenue implications of the authority's finances since, as a fundamental principle, all borrowings are secured on the authority's future revenue income. The CIPFA Prudential Code requires the prudential indicators in respect of external debt, as above, to be set and revised taking into account their affordability. It is through this means that the objectives of sustainability and prudence are addressed each year.