REPORT FOR DECISION

Agenda Item	

MEETING:	**RESOURCE AND PERFORMANCE SCRUTINY COMMISSION** **EXECUTIVE**
DATE:	**27 AUGUST 2009** **2 SEPTEMBER 2009**
SUBJECT:	**2008/09 TREASURY MANAGEMENT ANNUAL REPORT**
REPORT FROM:	**EXECUTIVE MEMBER FOR RESOURCE**
CONTACT OFFICER:	**MIKE OWEN, DIRECTOR OF FINANCE & E-GOVERNMENT**

TYPE OF DECISION:	**COUNCIL**
FREEDOM OF INFORMATION/STATUS:	This paper is within the public domain

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SUMMARY:

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 2008/09.

- Advantage was taken of rescheduling opportunities to lower the average interest rate of the loan portfolio. Rescheduling of loans in 2008/09 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, 5.33% in 2008/09 compared to 5.40% in 2007/08.

- The borrowing level increased during the year from £112.854 million to £121.538 million. New borrowing of £10 million originally scheduled for 2007/08 took

place in early 2008/09 to take advantage of favourable interest rates. There was a decrease in the investment balance from £36.294 million to £31.954 million due to cash flow requirements.

- There was a decrease in the rate of return on investments at 5.31% in 2008/09 compared to 5.83% in 2007/08. The fall was due to the impact of the credit crunch on the world banking system which caused interest rates to fall including the Council's investment returns in the second half of the year.

OPTIONS & RECOMMENDED OPTION

It is recommended that, in accordance with CIPFA's Code of Practice on Treasury Management, the report be noted.

IMPLICATIONS:

Corporate Aims/Policy Framework:

Do the proposals accord with the Policy Framework? Yes

Financial Implications and Risk Considerations:

See DoFEG comment for financial implications.

The last financial year saw unprecedented upheaval in the financial markets with a number of institutions requiring state aid to survive, some unforeseen mergers and some institutions failing. The authority has always operated on the basis of 'security first' and our already strict risk management arrangements were strengthened even further during the turmoil. As a result no money was lost as a result of the market's problems.

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 2009 in conformity 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 2008/09 gave approval that external borrowing would only be taken if long term rates remained favourable at a trigger rate of 4.45%.

	Long-term debt increased during the year, £121.854 million in 2008/09 compared to £112.854 million in 2007/08. The average borrowing rate fell due to rescheduling of loans. Investments at 31 March 2009 stood at £31.954 million, compared to £36.294 million the previous year. The average rate of return on investments was 5.31% in 2008/09 compared to 5.83% in 2007/08.
Equality/Diversity implications:	No - (see paragraph 8.1, page 9)
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, as part of the Council's Financial Procedure Rules and Budget and Policy framework, relating to Risk Management and Control of Resources: Treasury Management.
Are there any legal implications?	No
Staffing/ICT/Property:	There are no direct staffing, ICT or property implications arising from this report.
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
No	Yes		
Scrutiny Commission	Executive	Committee	Council
Resource and Performance Scrutiny Commission	Yes		**Yes**

1.0 BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management was 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 2008/09 strategy;
- economic review for 2008/09
- borrowing outturn for 2008/09
- investment outturn for 2008/09
- 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 2008/09 was as follows:

	31st March 2008 Principal £'000	Average Interest Rate	31st March 2009 Principal £'000	Average Interest Rate
Fixed Rate Funding:				
- PWLB	65,309		74,309	
- Market	39,000		39,000	
- Local Bonds	3		3	
Variable Rate Funding:				
- PWLB	0		0	
- Market	0		0	
Bury MBC Debt	104,312		113,312	
Airport Debt	8,542		8,226	
Total Debt	**112,854**	**5.40%**	**121,538**	**5.33%**
Total Investments	**36,294**	**5.83%**	**31,954**	**5.31%**

3.0 OVERVIEW OF THE STRATEGY FOR 2008/09

3.1 The strategy for 2008/09 was to take advantage of historically low rated long term external debt for capital financing purposes at around 4.45% and invest at rates which are expected to be around 5.00% in accordance with cashflow needs. Overall costs will be maintained at a minimum.

3.2 During 2008/09 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 Public Works Loans Board (PWLB) rate fell back to the central forecast rate of 4.45%. It was predicted that the 50 year rate would be lower than the shorter maturities.

3.3 The interest rate expectations for 2008/09 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 2008/09

4.1 The financial crisis, commonly known as the 'credit crunch', had a major downward impact on the levels of interest rates around the world. Although interest rates initially fell sharply in the US they were followed, eventually, by the Bank of England.

4.2 On 1st April 2008 Bank Rate was 5% and the Bank of England was focused on fighting inflation. Market fears were that rates were going to be raised as Consumer Prices Index (CPI), the Government's preferred inflation target, was well above the 2% target (two years ahead). The money market yield curve reflected these concerns with one year deposits trading well above the 6% level. PWLB rates in both 5 and 10 years edged above Bank Rate during the summer as markets maintained the belief that inflation was the major concern of the monetary authorities. The money markets were reflecting some concerns about liquidity at this time and the spread between Bank Rate and 3 month London Inter-bank Offered Rates (LIBOR) was greater than had historically been the case.

4.3 This phase continued throughout the summer until the 15th September when Lehman Brothers, a US investment bank, was allowed to file for bankruptcy in the total absence of any other institution being willing to buy it due to the perceived levels of toxic debt it had. This event caused a huge shock wave in world financial markets and threatened to completely destabilise them. This also led to an immediate spike up in investment rates as markets grappled with the implications this might have on other financial institutions, their credit standing and indeed their viability. On 7th October the Icelandic government took control of their banks and this was followed a few days later by the UK government pumping £37bn into three UK clearing banks, RBS/HBOS/Lloyds, as liquidity in the markets dried up. The Monetary Policy Committee (MPC) meantime had reduced interest rates by 50bp on 9th October. This had little impact on 3 month LIBOR, however, as the spread, or 'disconnect' as it became known, against Bank Rate widened out. On the other hand the short end of the PWLB fell dramatically as investors, very concerned about their counterparty limits post the Icelandic banks' collapse, fled to the quality of Government debt forcing yields lower.

4.4 Market focus now shifted from inflation concerns to concerns about recession, depression and deflation. Although CPI was still well above target it was seen as no barrier to interest rates being cut further. The MPC duly delivered another cut in interest rates in November, this time by an unprecedented 1.5%. Investors continued to pour money into Government securities across the curve, at the front end because of credit concerns and the longer end because of the economic consequences reducing inflation, driving yields in 10 year PWLB temporarily below 4% and 5 years to around 3.5%. In December as the ramifications of the 'credit crunch' became increasingly clear the Bank of England cut interest rates to 2% - a drop this time of 1%. The whole inter-bank yield curve shifted downwards but the 'disconnect' at the short end remained very wide, negating to some degree the impact of the cuts in Bank Rate. 50 year PWLB rates dropped below 4% at the turn of the year, marking the low point, as it turned out, in this maturity.

4.5 The New Year of 2009 brought little relief to the prevailing sense of crisis and on 8th January the MPC reduced rates by 0.5% to 1.5%, a record low. More Government support for the banking sector was announced on 19th January 2009. The debt markets had a sharp sell-off at this stage as they took fright at the amount of gilt issuance likely to be needed to finance the help provided to the banks. There was also discussion about further measures that could be introduced to kick start lending and economic activity. These included quantitative easing by the Bank of England, effectively printing money.

4.6 In February 2009 the MPC adopted the traditional method of monetary easing by cutting interest rates again by 0.5% to 1%. Inter-bank rates drifted down with the spread in the 3 months still well above Bank Rate. In early March Lloyds Banking Group, which now included HBOS, took part in the Government's Asset Protection scheme. The MPC cut interest rates yet again to 0.5% and announced the quantitative easing scheme would start soon. This scheme would focus on buying up to £75bn of gilts in the 5-25 year maturity periods and £10 - 15bn of corporate bonds. This led to a substantial rally in the gilt market, particularly in the 5 and 10 year parts of the curve, and PWLB rates fell accordingly. Finally at the end of March it was announced that the Dunfermline Building Society had run into difficulties and its depositors and good mortgages were taken over by Nationwide whilst the Treasury took on its doubtful loans.

4.7 The financial year ended with markets still badly disrupted, the real economy suffering from a lack of credit, short to medium term interest rates at record lows and a great deal of uncertainty as to how or when recovery would take place. Investment income returns have been badly hit but lower borrowing rates in short to medium periods had allowed indebted local authorities to benefit.

4.8 **Longer-term interest rates –** The PWLB 45-50 year rate started the year at 4.43% (25 year at 4.62%) and was then generally within a band of 4.3 - 4.6% (4.6% - 5.0%) until mid October when there was a spike up to 4.84% (5.08%) followed by a plunge down to 3.86% (4.03% late December) in early

December. Further spikes of 4.84% (4.86%) and 4.72% (4.69%) occurred in late January 2009 and early February with the year closing out at 4.58% (4.28%). It was not uncommon to see rates fluctuating by 40-50 basis points within a few weeks during this year.

5.0 BORROWING OUTTURN FOR 2008/09

5.1 The capital financing requirement (CFR) for 2008/09 highlighted the need to borrow £13.73 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 2008/09 debt stood at £121.54m and the CFR at £155.08m. Therefore, in theory, borrowing of £33.54m could be taken to finance past and present capital expenditure. New borrowing of £10 million originally scheduled for 2008/09 took place in early 2009/10 to take advantage of favourable interest rates.

5.2 In accordance with the 2008/09 strategy rates were monitored to take advantage of the lowest possible rates.

5.3 During the year two PWLB loans were rescheduled. A loan for £4m costing 4.25% in interest was repaid and a new loan of £4m costing 2.01% was taken out in its place. The loan repayment earned a discount of £0.196m. Another loan for £15m costing 4.25% in interest was repaid and two new loans of £7.5m, one costing 2.55% and the other costing 2.95%, were taken out. This loan repayment earned a discount of £0.279m.

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

	Balance at	**Loans**	**Loans**	**Balance**
	31.3.08	**Raised**	**Repaid**	**31.03.09**
	£000s	**£000s**	**£000s**	**£000s**
PWLB	65,309	14,000	5,000	74,309
Market	39,000	5,000	5,000	39,000
Other loans	3	0	0	3
Bury MBC Debt	**104,312**	**19,000**	**10,000**	**113,312**
Airport PWLB Debt	**8,542**	**0**	**316**	**8,226**
Total Debt	**112,854**	**19,000**	**10,316**	**121,538**

5.5 The approach during 2008/09 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	02/03	03/04	04/05	05/06	06/07	07/08	08/09
Average Interest Rate on Debt	5.88%	5.74%	6.21%	5.85%	5.50%	5.40%	5.33%

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 £11 million 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 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 2008/09

6.1 The Council manages its investments in-house (with advice from Sector) 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. When making investment decisions, the Council has regard to the Guidance on Local Government Investments issued by the DCLG in 2004 and CIPFA's Treasury Management Code of Practice.

6.3 Institutions in which investments were made did not have any difficulty in repaying investments and interest in full during the year, reflecting the sound risk management activities undertaken by the treasury team.

6.4 The investment strategy for 2008/09 approved by Council in February 2008 forecast the bank rate to remain static in the range 4.75% to 5% throughout 2008/09. The effects of the credit crunch, however, saw bank rate fall dramatically to 0.50% by the end of the financial year. As a consequence the Council's investment returns were lower than forecast in the second half of the financial year. However Members should note that pro active action taken by the treasury team meant that the average rate earned dropped by a mere 0.07% compared to a base rate fall of 5.5%.

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 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 Investment	Rate of Return	Benchmark Return *
Internally Managed	£57,814,311	5.31%	3.69%

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

6.7 Investments at 31 March 2009 stood at £31.95m (£36.29m at 31 March 2008), whilst the average for the year was £57.81m (£52.64m at 31 March 2008). The increase in the weighted average investments from 2007/08 to 2008/09 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 £2.996 million compared to £2.988 million in 2007/08. The reduction in interest rates was offset by the 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 the Council's Treasury Policy Statement and annual Treasury Management Strategy Statement. The outturn for the Prudential Indicators is shown in Appendix 1.

8.0 EQUALITY AND DIVERSITY

8.1 There are no specific equality and diversity implications.

9.0 FUTURE ACTIONS

9.1 Treasury Management Updates and Prudential Indicators for 2009/10 will be presented on a quarterly basis to the Executive and Resource and Performance Scrutiny Commission.

10.0 CONCLUSION

10.1 It is recommended that Members note the treasury management activity that has taken place during the financial year 2008/09.

Councillor Iain Gartside
Executive Member for Resource

Background documents:

Unaudited Final Accounts Bury MBC 2008/09
CIPFA Treasury Management Code of Practice in the Public Services
CIPFA The Prudential Code for Capital Finance in Local Authorities
Sector's Annual Treasury Management Report 2008-09
Financial markets and economic briefing papers
For further information on the details of this report and copies of the detailed variation sheets, please contact:

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Prudential Indicators 2008/09 — Appendix 1

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 2008/09 were not breached and were kept within their limits.

The table below shows the Prudential Indicators for 2008/09.

CAPITAL EXPENDITURE	**Original Budget 2008/09**	**Actual Outturn 2008/09**	**variance**
	£'000	**£'000**	
Estimate of Capital Expenditure			
Non-HRA	25,261	36,010	
HRA	12,754	16,174	
TOTAL	**38,015**	**52,184**	37.27%
Estimate of Capital Financing Requirement (CFR)			
Non-HRA	115,117	116,723	
HRA	38,183	38,357	
	153,300	**155,080**	1.16%

AFFORDABILITY	**Original Budget 2008/09**	**Actual Outturn 2008/09**	**Variance**
Estimate of incremental impact of capital investment decisions			
Increase in council tax (band D, per annum)	£7.47	£12.29	
Increase in housing rent per week	£0.00	£0.00	
Ratio of Financing Costs to net revenue stream			
Non-HRA	2.52%	5.25%	108.33%
HRA	6.18%	6.22%	0.65%
Net External Borrowing only to support the CFR in Medium Term	**£'000**	**£'000**	
Net External borrowing over medium term	133,141	121,538	
Total CFR over Medium Term	153,277	155,080	
Net External Borrowing < Total CFR	TRUE	TRUE	

EXTERNAL DEBT	**Original Budget 2008/09**	**Actual Outturn 2008/09**	**variance**
	£'000	**£'000**	
Actual External Debt		121,538	
Authorised limit of external debt			
Borrowing	211,500	211,500	
other long term liabilities	9,400	9,400	
TOTAL	220,900	220,900	0.00%
Operational boundary			

Borrowing	177,600	177,600	
other long term liabilities	9,400	9,400	
TOTAL	187,000	187,000	0.00%

TREASURY MANAGEMENT	**Original Budget 2008/09**	**Actual Outturn 2008/09**	**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 2008/09	Upper/lower limit	Actual	
Under 12 months	10% - 0%	3.6%	
12 months and within 24 months	35% - 0%	1.8%	
24 months and within 5 years	40% - 0%	21.9%	
5 years and within 10 years	50% - 0%	4.6%	
10 years and above	90% - 30%	68.1%	

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.