Annual Treasury Management Report 2007/08

Finance and Administration Committee

Committee:	**Finance and Administration Committee**	**Agenda Item**
Date:	**25th September 2008**	**9**
Title:	**Annual report on Treasury Management and Prudential Indicators 2007/08**	
Author:	**Toby Cowper, Principal Accountant – Capital and Technical. 01799 510 642.**	Item for decision

Summary

The annual treasury report is a requirement of the Council's reporting procedures and has to be approved by the 30th September following the end of the financial year. It covers the treasury activity for 2007/08, and the actual Prudential Indicators for 2007/08.

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. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

Recommendations

The Committee is recommended to:

- Note the actual 2007/08 prudential indicators within the report.
- Note the treasury management stewardship report for 2007/08.

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Background Papers

- CIPFA Code of Practice on Treasury Management
- Interest rate forecasts and other guidance provided by the Council's external treasury consultants
- Treasury management working papers held within Financial Services

Impact

Communication/Consultation	There are no specific communication implications contained in this report.
Community Safety	There are no specific community safety implications contained in this report.
Equalities	There are no specific equalities implications contained in this report.

Annual Treasury Management Report 2007/08

Finance and Administration Committee

Finance	This report sets out the treasury management activities during 2007/08, the interest earned on the Council's balances and its compliance with the Prudential Indicators
Human Rights	There are no specific Human Rights implications contained in this report.
Legal implications	The treasury management function complies with the legislation as set out in Section 27 of this report.
Ward-specific impacts	There are no specific ward implications contained in this report.
Workforce/Workplace	There are no specific workforce/workplace implications contained in this report.

Situation

Introduction

1. This report summarises:

- The Council's capital expenditure for the year;
- How this expenditure was financed;
- The impact on the Council's indebtedness for capital purposes;
- The Council's overall treasury position;
- The reporting of the required prudential indicators;
- A summary of interest rate movements in the year;
- Debt activity; and
- Investment activity.

The Council's Capital Expenditure and Financing 2007/08

2. The Council undertakes capital expenditure on long term assets. These activities may either be:

    - Financed immediately through capital receipts, capital grants and revenue contributions
    - If insufficient financing is not immediately available the expenditure will give rise to a borrowing need.

3. Part of the Council's treasury activities is to address any borrowing need, through either borrowing from external bodies such as the Public Works Loan Board, (PWLB), or utilising temporary cash resources within the Council. The wider

treasury activities also include managing the Council's cash flows, any previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then to optimise the return on performance.

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

	2007/08 Revised Estimate £'000	**2007/08 Actual £'000**
Non-HRA capital expenditure	1,969	1,146
HRA capital expenditure	2,898	2,931
Capitalisation of Redundancy	490	490
Total capital expenditure	**5,356**	**4,567**
Resourced by:		
Capital receipts	(2,029)	(1,423)
Capital grants	(690)	(643)
Capital reserves – S106	(331)	(195)
Major Repairs Allowance - HRA	(1,851)	(1,851)
Revenue – HRA	(455)	(455)
Unfinanced capital expenditure (additional need to borrow)	**0**	**0**

The Council's Overall Borrowing Need

5. 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. This Council has fully financed its current capital expenditure and so it currently has only its historic borrowing (2006/07 finance lease - waste vehicles). The Council's CFR for 2007/08 was therefore £1.9m

CFR (£m)	**31 March 2008 Actual**
Opening balance	2,166
+Unfinanced capital expenditure	0
- Minimum revenue provision	(266)
Closing balance	**1,900**

Treasury Position at 31 March 2008

6. Whilst the Council's gauge of its underlying need to borrow is the CFR, the Council's in-house treasury function can manage any possible actual borrowing position by either:
   - borrowing up to the Capital Financing Requirement; 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. During 2007/08 the Council did not take up any additional long term borrowing to finance the capital programme. This situation was anticipated in the 2007/08 Treasury Management Strategy approved by Full Council on 15th February 2007.

Prudential Indicators and Compliance Issues

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

Net Borrowing and the Capital Financing Requirement

10. 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 2007/08 plus the expected changes to the CFR over 2008/09 and 2009/10. The Councils net borrowing position must be lower than the CFR, so the Council has complied with this prudential indicator.

	31 March 2007 Actual	31 March 2008 Actual
Net borrowing position	**£1,775**	**£1,509**
CFR	**£2,166**	**£1,900**

The Authorised Limit

11. 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 in paragraph 13 demonstrates that during 2007/08 the Council has maintained gross borrowing within its Authorised Limit.

The Operational Boundary

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

Actual financing costs as a proportion of net revenue stream

13. This indicator identifies the degree by which borrowing affects the Council's General Fund and Housing Revenue Account budgets.

	2007/08
Original Indicator - Authorised Limit	**£5m**
Maximum gross borrowing position	**£1.8m**
Original Indicator – Operational Boundary	**£2m**
Average gross borrowing position	**£1.6m**
Minimum gross borrowing position	**£1.5m**
Financing costs as a proportion of net revenue stream	**£0.04m**

Economic Background for 2007/08

14. All treasury activity is directed by both the current market interest rates and expectations of future movements. For example, longer term investment rates for one and two years will reflect anticipated movements in the Bank of England Monetary Policy Committee (MPC) rate (UK Repo Rate). Longer term borrowing rates are influenced by inflation and demand and supply considerations.

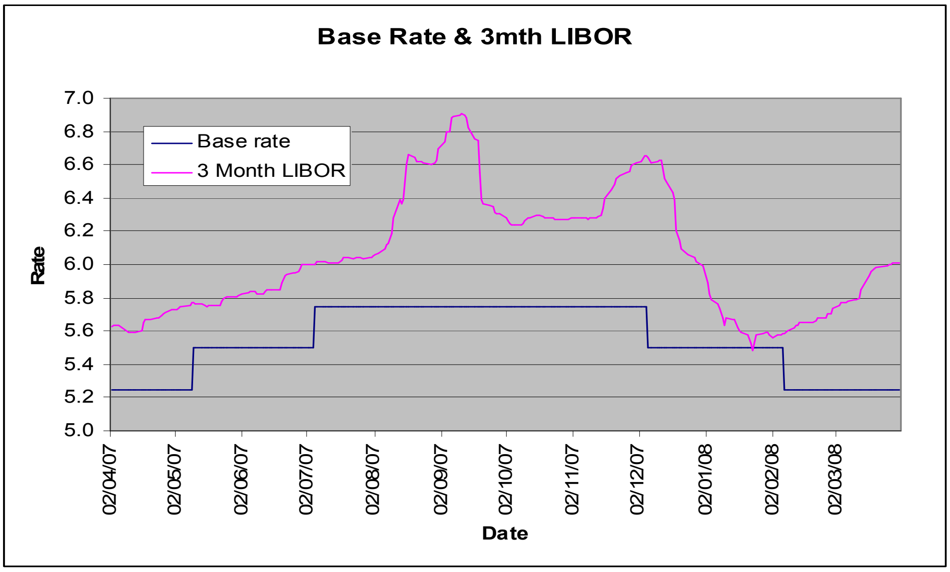
15. The rising trend in UK interest rates continued in the first half of the 2007/08 financial year. The domestic economic backdrop continued to present problems for the Monetary Policy Committee, notably in the early summer. CPI inflation breached the 3% upper limit of the Government's target range in April (reported in May), consumer spending growth remained buoyant and an expanding number of companies expressed intentions to raise prices.

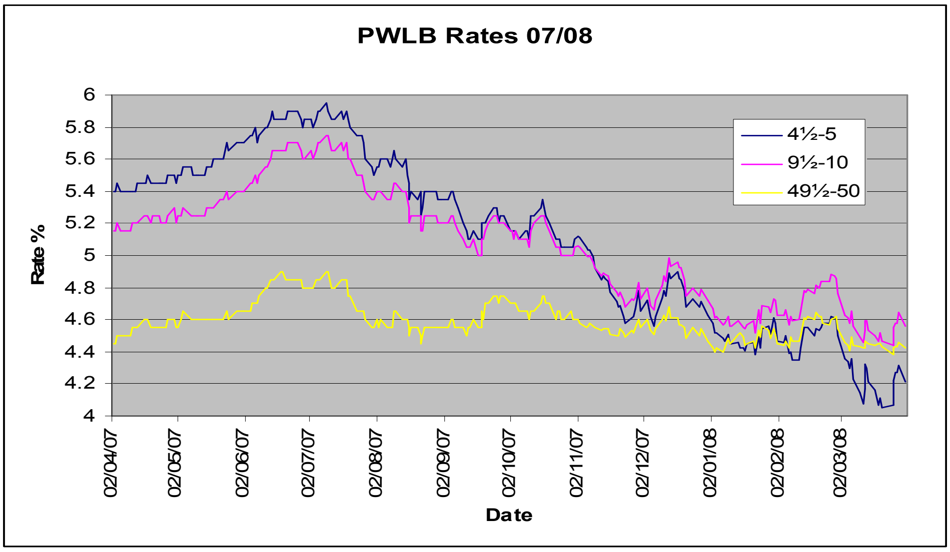
16. Official Bank Rate was raised to 5.5% in May and 5.75% in July in response to the deteriorating inflation outlook. In addition, the Bank of England's May and August Inflation Reports hinted that more hikes might be necessary.

Interest Rates

End Qtr	Bank Rate	LIBOR – London inter bank offer rate			PWLB – Public Works Loans Board rates		
		3mth	6mth	1yr	5yr	20yr	50yr
2007 Mar	5.25	5.6	5.8	5.9	5.35	4.8	4.45
Jun	5.5	6	6.1	6.3	5.8	5.2	4.8
Sep	5.75	6.3	6.3	6.2	5.25	5	4.75
Dec	5.5	6	6	5.8	4.64	4.63	4.47
2008 Mar	5.25	6	6	5.8	4.14	4.7	4.43

17. The market was plunged into chaos in late August as the tightening of credit conditions, triggered initially by the failure of a number of US mortgage lending institutions, undermined investor confidence. LIBOR rates rose to well over 6.5% as financial organisations' reluctance to lend money to counterparties sparked a severe shortage of funds in the market. In the UK, the crisis came to a head with the failure of the Northern Rock Bank (September) and while the danger of potential meltdown was defused by the Government's decision to guarantee all deposits with this institution, this failed to prevent a prolonged tightening of credit conditions.
18. Central banks strove to boost market liquidity via the injection of funds to the banking system and there were signs that this might be working in January. But a series of disappointing financial results and a persistent undercurrent of mistrust ensured a wide margin between official and market rates continued to year end.
19. The credit crisis provoked a significant change in the Bank of England's assessment of UK economic prospects over the medium term. It was clearly concerned that the tightening of liquidity and the consequent rise in borrowing rates across the entire economy could lead to a rapid slowdown in activity. This would help to contain inflation pressures. Bank Rate was cut by 0.25% on two occasions, December and February, to end the financial year at 5.25%.
20. Long-term rates (gilt yields & PWLB rates) charted an erratic course. The upward pressure on rates in evidence in the closing stages of 2006/07 continued into the new financial year as concerns persisted that international interest would need to rise further to combat mounting inflation pressures.
21. Gilt yields peaked in late June and started to slip lower in the summer months. The flight to safe investments triggered by the financial crisis placed strong downward pressure upon gilt-edged yields in August/September notably at the short end of the maturity range and the rally in this part of the market gained momentum as the year drew on.
22. Progress to lower levels was erratic and limited in the early months of 2008, but the general trend in yields was to lower levels. The most notable development was the reversion of the yield curve to a strongly-positive incline.





The Strategy Agreed for 2007/08

23. The strategy provided for 2007/08 expected interest rates to fluctuate during the year. This was based on the view of Butlers, the Council's Treasury advisors, who anticipated that Interest rate uncertainty was set to persist in the year ahead. In particular the threat of higher inflation was considered a real danger for the UK economy in the short term and consequently a further base rate rise of 0.25%, anticipated in March 2007. Expectations on shorter-term interest rates showed a likelihood of peaking at 5.50% in the early part of 2007 and dropping off thereafter.

    On this basis the Council's in-house treasury strategy was to, cash flow permitting, seek to lock into some longer-period investments at higher rates before the money markets started to build in any reductions in interest rates.

Investment Policy

24. The Council's investment policy was governed by the Office of the Deputy Prime Minister (ODPM) now DCLG, Guidance, which was implemented in the annual investment strategy approved by Council on 15 Feb 2007. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources

25. The Council's longer term cash balances comprise primarily revenue and capital resources, although these will be influenced by cash flow considerations. The Council core cash resources comprised:

Balance Sheet Resources (£m)	31 March 2007 £m	31 March 2008 £m
Balances, incl. HRA/Collection Fund	**1,777**	**1,714**
Earmarked reserves	**1,546**	**1,161**
Unapplied Capital Grants	**133**	**229**
Provisions	**125**	**125**
Usable capital receipts	**4,495**	**3,680**
Total	**8,076**	**6,909**

Investments Held by the Council

26. The Council maintained an average balance of £14.6m during 2007/08 which included £8.1m of fixed term deposits including £2.2m held on behalf of the Stansted Housing Partnership. During the year these balances generated an average return of 5.72%. The comparable performance indicator is the average 7-day LIBID rate, which was 5.58%.

Investments held by the Council as at 31 March 2008 were:

31 March 2007 £m		31 March 2008 £m
7,400	Fixed Term Deposits	**2,200**
13	Bank of Scotland Corporate Base Plus A/c	**4,009**
1367	Allied Irish Bank	**2,427**
8,780		**8,636**

This produced Investment Income to the General Fund of £611k compared to the Revised Estimate of £584k.

Regulatory Framework, Risk and Performance

27. 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;

    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 ODPM (now DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities.

28. 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.

29. 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.

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
That the Council does not comply with the Code of Practice on Treasury Management	Risk level 1, as treasury controls are in place to meet requirements.	Risk level 3, due to significant sums of money invested externally.	Separation of duties and monitoring of the lending criteria against the approved lending list from the councils treasury management advisers, minimising risk