Committee:	**Finance & Administration**	**Agenda Item**
Date:	**16 September 2010**	**8**
Title:	**Annual report on Treasury Management and Prudential Indicators 2009/10**	
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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 2009/10, and the actual Prudential Indicators for 2009/10.

Recommendations

The Committee is recommended to:

Note and approve the actual 2009/10 prudential indicators within the report.

Note and approve the treasury management outturn for 2009/10.

Scope

This report is prepared in accordance with the CIPFA Treasury Management Code and the Prudential Code.

Presents details of capital financing, borrowing, debt rescheduling and investment transactions during the year.

Reports on the risk implications of treasury decisions and transactions;

Gives details of the outturn position on treasury management transactions in 2009/10.

Confirms compliance with treasury limits and Prudential Indicators.

Impact

Communication/Consultation	None
Community Safety	None
Equalities	None
Finance	This report sets out the treasury management activities during 2009/10, the interest earned on the Council's balances and its compliance with the Prudential Indicators
Human Rights	None
Legal implications	None
Ward-specific impacts	None
Workforce /Workplace	None

Background

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.

Uttlesford District Council approves the treasury strategy and it receives a strategy report at the beginning of each financial year identifying how it is proposed to finance capital expenditure, borrow and invest in the light of capital spending requirements, interest rate forecasts and economic conditions. The Finance and Administration Committee monitors the implementation of the treasury strategy and activity and reports are received at each meeting, including this annual treasury outturn report.

The Prudential Capital Finance System came into force on 1st April 2004. The Council determines at a local level 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.

The DCLG's Guidance on Local Government Investments in England came into effect on 1st 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.

Revisions to the CIPFA Treasury Management and Prudential Codes, CLG Guidance on Investments

In November 2009 CIPFA released the revised Code of Practice for Treasury Management in the Public Services and accompanying Guidance Notes and the revised Prudential Code for Capital Finance in Local Authorities. The CLG also issued revised Guidance on Local Authority Investments for English authorities. The revised Codes/Guidance re-emphasise an appropriate approach to risk management, particularly in relation to the security and liquidity of invested funds. Authorities were also henceforth required to demonstrate value for money when borrowing in advance of need and ensure the security of such funds. Authorities are now also required to have a separate body or committee responsible for the scrutiny of the treasury function.

The Council has revised its treasury policy and practices to take account of the requirements and changes in the revised Codes and Guidance.

Economic Outlook for 2009/10

At the time of determining the Treasury Strategy Statement for 2009/10 in the outlook for the economy and interest rates was as follows:

The UK, Eurozone and US economies were contracting, globally economies faced a prolonged recession or period of weakness following the financial market meltdown in the autumn of 2008. Availability of credit was restricted as banks undertook to repair their balance sheets. This exacerbated the slowdown as finance for small businesses effectively came to a standstill.

The increase in food and energy inflation which had exerted a powerful squeeze on real incomes in 2008 was, however, expected to fade in 2009. Wage inflation was forecast to remain low and the labour market to remain weak; the threat of unemployment was likely to influence consumers to scale back spending and save instead.

The UK Bank Rate had been cut to 0.5% and in March 2009 the Bank of England announced its initial £75bn of Quantitative Easing (QE). There remained a sizeable gap between short-dated LIBOR rates (i.e. the rates at which a banks are willing to borrow from other banks) and the Bank Rate; this gap was forecast to narrow. Gilts were expected to benefit from QE, resulting in lower yields.

The economy and events in 2009-10

After the particularly torrid economic recession and a severe downturn in growth that extended into early 2009, there were reports of nascent recovery. The Bank of England forecast UK growth to fall by 3.9% in 2009, whilst inflation was forecast to be heading lower and staying lower for longer. The depth of the recession was borne out by the 5.9% year-on-year fall in GDP recorded at the end of the second quarter of 2009. The service sector - the dominant element of UK economy - also stalled for much of early 2009 despite a number of optimistic surveys to the contrary. Green shoots of recovery were finally evident in the final quarter of 2009 with growth registering 0.4% for the quarter.

Consumer Price Inflation, having hit a high of 5.2% in September 2008, began the year at 3.2% (Feb 2009 data), fell to a low of 1.1% in September 2009 as the oil, commodity, utility and food prices (the main drivers of high inflation in 2008) fell out of the year-on-year statistical calculations. Thereafter, inflation pushed higher with rising oil and transport costs and VAT reverting to 17.5%. CPI at year end was 3.0% (Feb 2010 data).

Companies and households on the whole reduced rather than increased their levels of debt. Credit remained scarce and at a premium, and certainly as compared to that available two years earlier. Businesses retrenched rather than hired workers and unemployment rose rapidly to just under 2.5 million. Against this background, wage growth was muted.

The November 2009 Budget was primarily about public debt. The Chancellor's forecast for net public sector borrowing in 2009/10 was £175bn or 12.4% of GDP. Gross gilt issuance was expected to hit a quite staggering £220bn in 2009/10. Standard & Poor's responded to the debt that the UK government was building up and a lack of a credible plan to reduce the debt burden by changing the UK's rating outlook from stable to negative.

The outlook for 2010 was therefore for a period of slow and patchy growth in the economy accompanied by stubbornly high unemployment. The UK fiscal deficit remained acute. Cuts in public spending and tax increases were becoming inevitable and a credible plan to reduce the deficit was urgently required after the May General Election, the absence of which increased the potential of a sovereign downgrade. The likelihood of a hung parliament had grown and had the potential of being disruptive to financial markets.

Treasury Portfolio 2009-10

Balance at 1/4/2009 £m		Balance at 31/3/2010 £m
- -	Long-term Borrowing Temporary Borrowing	- -
-	**Total borrowing**	**-**
(7.392)	Other long-term liabilities* + PFI Schemes (a requirement for 2009/10)	(6.921)
(7.392)	**Total External Debt**	**(6.921)**
1.682 7.501 1.686	Cash at Bank Short Term Investments Long Term Investments	1.338 6.113 1.653
10.869	**Total Investments**	**9.104**
3.477	**Net Investment Position**	**2.183**

* The 2009 CIPFA SORP has resulted in the PFI related long term assets and liabilities being brought onto the Council's Balance Sheet in 2009-10. The aggregate External Debt including PFI liabilities increased above the Council's Prudential Borrowing Limit.

Long-term Borrowing & other Long-term Liabilities

	Balance At 1/4/2009 £m	Maturing loans £m	Loan Repayment £m	New Borrowing £m	Balance at 31/3/2010 £m
Long-term Borrowing	-	-	-	-	-
Temporary Borrowing	-	-	-	-	-
Total borrowing	**-**	**-**	**-**	**-**	**-**
Other long-term liabilities	(7.392)	-	0.471	-	(6.921)
TOTAL EXTERNAL DEBT	(7.392)	-	0.471	-	(6.921)

The Council had no longer term debt at the beginning of the Prudential regime on 1st April 2004. Although there are now no significant advantages in remaining "debt-free", the Council's decision was not to borrow long-term monies to finance its capital spending, relying instead on government grants / usable capital resources / revenue contributions, etc. The need to borrow in accordance with the Council's requirement will be kept under review in 2010-11.

Capital Expenditure Financing

Source	Amount £000
Government Grants	261
Usable Capital Resources	865
Major Repairs Reserve	1,925
S106	80
Revenue Contributions	246
TOTAL	**3,377**

Annual Investment Strategy and Outturn

The Council held average cash balances of £15.149m during the year. These represent working cash balances / capital receipts and the Council's reserves.

The CLG's Guidance on Investments, revised during 2009/10, reiterated security and liquidity as the primary objectives of a prudent investment policy. Although the Guidance becomes operative on 1st April 2010, its principal recommendations run parallel to the credit risk management requirements in the revised Treasury Management Code. In the revised Guidance, Specified Investments are those made with a body or scheme of "high credit quality". Both the Guidance and the revised Treasury Management Code emphasise that counterparty credit criteria should not rely on credit ratings alone but should include a wider range of indicators. The revised Code nonetheless requires that ratings assigned by all three rating agencies – Fitch, Moody's and Standard & Poor's – be taken into account and the lowest rating be used.

Credit criteria, counterparty risk and selection: In determining suitable investment counterparties, the Council was, in any event, already taking into consideration economic and financial information as well as evaluating alternative assessments of credit strength (for example, potential sovereign support, sovereign strength as evidenced by the ratings and GDP, sovereign and counterparty credit default swaps).

Managing counterparty risk continued to be the Council's overwhelming investment priority. Financial markets remained in a febrile state particularly at the beginning of 2009/10. Against this backdrop, the Council continued to place investments with a small, select list of counterparties.

'Specified' and 'non-specified' investments were determined for use having assessed their risks and benefits in relation to the Council's particular circumstance, risk threshold and investment objectives. New investments were restricted to the DMO, AAA-rated Money Market Funds, investments with banks and building societies which are Eligible Institutions under the UK Government's 2008 Credit Guarantee Scheme and with a long-term AA- (AA minus) rating. The Council accepted the diminution in investment return from investing with highly rated counterparties as an acceptable risk-reward trade-off.

INVESTMENTS	Balance at 01/4/2009 £000	Impairment in year £000	Balance at 31/3/2010 £000
Money Market Lending (short-term)	3,006	-	2,005
Government deposit account	1,500	-	-
Barclays BPA Plus Account	-	-	100
Santander UK PLC	1,995	-	2,007
Bank of Scotland	1,000	-	-
Money Market Funds	-	-	2,001
Longer-term investments*	1,686	(33)	1,653
TOTAL INVESTMENTS	**9,187**	**(33)**	**7,766**

* The Landsbanki investment was reclassified as a long-term investment in 2008/09

The Council's existing investments are a combination of short-term investments and deposit accounts which reflect previous treasury management strategies and decisions. The mix of short-term investments and investments enables the Council to maintain an appropriate level of liquidity and enables it to mitigate re-investment risk (the risk that a large proportion of maturing investments is reinvested when interest rates are at a cyclical low).

Investment Income

The Council's investment income for the year was £0.091m compared to a budget of £0.106m.

Increased use of the Government's deposit account, which pays very low interest in return for maximum security, is the reason for the shortfull.

Minimum Revenue Provision (MRP)

There is now a statutory requirement to make a "prudent provision" for MRP (SI 2008 No.414). Statutory Guidance issued by the DCLG in March 2008 makes recommendations to local authorities on the interpretation of the term "prudent provision". Local authorities are to have regard to this Guidance which provides four options:

Option 1:	Regulatory Method
Option 2:	CFR Method
Option 3:	Asset Life Method
Option 4:	Depreciation Method

Options 1 and 2 can be used on all capital expenditure incurred before 1st April 2008 and on Supported Capital Expenditure on or after that date. Options 3 and 4 are considered prudent options for Unsupported Capital Expenditure on or after 1st April 2008 and can also be used for Supported Capital Expenditure whenever incurred.

The Council's has used Option 3 for 2009/10, this resulted in the Council making a £325,000 minimum revenue provision.

UDC makes minimum revenue payments to cover the capital cost of its long term liabilities (Waste service, finance lease and Leisure PFI payments)

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

The Council implemented its treasury strategy within the limits and parameters set in its treasury policy statement and Prudential Indicators against the prevailing market opportunities as follows:

(a) Financing its capital spending from government grants / usable capital resources / revenue contributions, etc. rather than from external borrowing.

(b) Adhering to the paramount requirement of safeguarding the council's invested balances during a period of unprecedented money market dislocation; tightening the minimum credit criteria for lending in response to the credit crisis and maintaining adequate diversification between institutions; optimising investment returns subject to the overriding requirement of security and liquidity.

(b) Forecasting and managing cash flow and undertaking short-term borrowing and lending to preserve the necessary degree of liquidity.

Reported Issues

On 1 July, 2 loans were "rolled forward", as is normal practice, but on this occasion, the interest earned on the original deposit was reinvested instead of paid over to the Council. This means that for two counterparties, the £2m limit was temporarily exceeded by a small amount.

This was in reported to the Finance and Administration Committee in September 2009/10.

Treasury-related Prudential Indicators

The Council at its meeting on 10th February 2009 approved the recommended Prudential Indicators for 2009/10.

Authorised Limit
This is the maximum amount of external debt that can be outstanding at one time during the financial year. The limit, which is expressed gross of investments, is consistent with the Council's existing commitments, proposals for capital expenditure and financing and with its approved treasury policy and strategy and also provides headroom over and above for unusual cash movements. This limit was originally set at £9.6m for 2009/10 but was then revised to £7.0m.

Operational Boundary
This limit is set to reflect the Council's best view of the most likely prudent (i.e. not worst case) levels of borrowing activity and is based on the Authorised Limit excluding the headroom for unusual cash movements. For 2009/10 the limit was set at £5.6m but was then revised to £5.0m.

The levels of debt are measured on an ongoing basis during the year for compliance with the Authorised Limit and the Operational Boundary. The Council maintained its total external borrowing within both limits.

The Council's PFI contract, which for technical accounting reasons is now recorded as a long-term liability on the Councils balance sheet, was £5.430m as at 31/3/2010.

Upper Limits for Interest Rate Exposure

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.

	Estimated Original Budget £m	Estimated Revised Budget £m	Actual Maximum £m
Upper Limit for Fixed Rate exposure	25	25	16.5
Upper Limit for Variable Rate exposure	25	25	6.4

Maturity Structure of Fixed Rate borrowing

This indicator is to limit large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates. It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate.

	Upper limit %	Lower limit %	Actual Borrowing as at 31/3/2010 £	Percentage of total as at 31/3/2010 %
under 12 months	-	-	-	-
12 months and within 24 months	-	-	-	-
24 months and within 5 years	-	-	-	-
5 years and within 10 years	-	-	-	-
10 years and above	-	-	-	-

Total principal sums invested for periods longer than 364 days

This indicator is set in order to allow the Council to manage the risk inherent in investments longer than 364 days.

For 2009-10 only the non-repaid Landsbanki investment was classified as a long term investment.

Balanced Budget The Council complied with the Balanced Budget requirement.

External Service Providers Arlingclose is appointed as the Council's treasury management advisor. The Council is clear as to the services it expects and is provided under the contract. The service provision is comprehensively documented. The Council is also clear that overall responsibility for treasury management remains with the Council.

Overall Conclusion During 2009/10 the Council complied with its treasury management strategy and within its Prudential Indicators, apart from a minor technical breach highlighted above as 'Reported Issues'.