Appendix A

Treasury Management Outturn Report 2009/10

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Introduction and Background

1. The Council's Treasury Management function is concerned with the management of the Council's debts, investments, cashflow and banking arrangements. These activities are regulated by a variety of professional codes and statutes and guidance. More specifically, 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. "

2. It is a requirement of the Council's Treasury Management Policy that a report is presented to the Council's Executive providing details of the treasury management activities undertaken in the preceding financial year. This annual report provides Councillors with the following information for 2009/10:-

   i) Economic Commentary on the year
   ii) Investment Activity
   iii) Borrowing Activity
   iv) Compliance with Treasury Limits
   v) Banking Facilities
   vi) Treasury Advisors

3. In addition to the matters raised above, this report provides details of the Council's performance against a series of prudential indicators which were established following the introduction of the Prudential Code for Capital Finance in Local Authorities in 2004/05.

Economic Commentary for 2009/10

4. **Appendix A** sets out the economic background in which the Council's treasury management function has operated in during 2009/10. This is provided to give Councillors an overview of market conditions, particularly the movement in base rates and the longer terms PWLB rates, against which the Treasury function has performed during the year.

5. As explained at **Appendix A**, following the turmoil in the financial markets experienced during 2008/09, the financial year 2009/10 has seen some unprecedented activity in the global financial markets as a result of the impact of the 'credit crunch'. To a large extent, the Council has been protected from the worst effects of this due to debt being largely at fixed rates and employing a cautious investment strategy.

6. Going forward, however, lower interest rates and the continuing instability in the financial markets have both impacted on the Council's ability to lend funds and achieve a reasonable return. As ever, the focus of the investment strategy remains the protection of the Council's capital investment over the returns achieved. To this end, we have been pursuing a strategy of using internal borrowing to fund capital investment, both because of the limited returns on investment and a conscious decision to reduce the level of funds under investment. More details of this are included in the Treasury Strategy for 2009/10. Given the continuing uncertainties in the financial markets, the Investment Strategy remains largely unchanged with the protection of capital the primary objective.

Borrowings

Long Term Borrowing

7. At the beginning of the current financial year, the Council had long-term loans of £9.859m, comprising wholly of Public Works Loan Board (PWLB) debts. During the year, there have been the following changes in the Council's debt portfolio:-

   a) repayment of a PWLB loan of £2m which expired on 31st October 2009;

   b) to replace the loan repaid above, additional PWLB loan debt of £2.0m was taken on 20th August 2009. This comprised two loans of £1m each and are for c4 years and c9 years respectively. Councillors should note that these loans were taken in advance of the repayment date of the loan in (a) above because of the expectation that interest rates will increase in the future;

   c) repayment of a PWLB loan of £750k which expired on 29th January 2010.

8. The original strategy for long term debt at the beginning of the financial year was not to replace the loans repaid above. However, in view of the expectation that interest rates at the medium to longer end would start to rise, current interest rates and in recognition of the short-term maturity structure of the Council's debt, the strategy was changed to lengthen the maturity structure of the Council's debt portfolio whilst interest rates remain relatively low. The rationale here is to reduce the risk of having to replace debt when interest rates could be significantly higher.

9. Overall, therefore, the balance of the Council's long term debt as at 31st March 2010 was £9.109m (although technically it should be noted that the debt comprises £5.872m long term debt and £3.237m of short term debt which is due for repayment within 2010/11). An analysis of the Council's long-term debt portfolio (and how it has changed since 1st April 2009) is provided at **Appendix B** whilst **Appendix C** provides an analysis of the maturity dates for this debt. It should be noted that the current average cost of this debt is 3.32% (which is slightly higher than at the beginning of the financial year when it was 3.15%).

10. The General Fund Revised Budget for debt charges for 2009/10 was £651,770 comprising £330,590 for interest on outstanding debt, £320,000 for the minimum revenue provision and £1,180 for premia payable as a result of debt restructuring exercises in previous years. Actual debt charges for the year were (including MRP and premia) £647,225, a saving of £4,545 when compared to the budget.

Short Term Borrowing

11. Subject to daily cashflow, the Council borrows funds on a temporary basis to meet cashflow deficits; this is a normal part of the treasury management process. During 2009/10 it was necessary to borrow temporarily on 13 occasions (total borrowings of £10.0m) at an overall cost for the year of £2,378.

12. At the end of the financial year, the Council had repaid all of the temporary loans.

Investments Activity

13. The Council manages its in investments in-house. All investments were placed with institutions authorised in accordance with the Council's Treasury Management Practice Notes. Investments are made for a range of periods, dependent on the Council's cash flows, its interest rate view and the interest rates on offer.

14. The Council started the year with investments of £13.900m reducing to £8.500m by 31st March 2010. The level of investment activity is summarised in table 1 below:-

Table 1: Investment Activity 2009/10

	£000	No.
Opening Balance	13.900	7
New Investments	69.175	261
Investments Realised	(74.575)	264
Balance of Investments at 31st March 2010	**8.500**	**4**

15. As the table indicates, a total of 261 investments amounting to £69.175m were placed at various times during the year, details of which were reported to the Executive as part of the regular Corporate Monitoring reports. A summary of all investments placed and realised during the year is provided at **Appendix D** which also shows the interest rate of return with each Counterparty. A graph showing the balance of amounts under investment during the year is provided at **Appendix E**.

16. The Approved Budget for interest and investment income for 2009/10 on the General Fund was £321,410 whilst the actual level achieved was £381,844, some £60,434 more than budgeted. The main reason why investment income for the year has exceeded budget is the amount of surplus cash balances which have been higher than anticipated primarily due pro-active management of the Council's cash balances and the underspend on the Council's Capital Programme.

17. In relation to investment performance for 2009/10, in its simplest terms, the actual return on investments is a function of the amount of surplus cash available for investment, the timing of investments and the interest rates at which any such funds are invested. As the Council's investments are restricted to cash deposits (to authorised counterparties), the interest returns achieved are generally linked to the bank base rate as determined by the Monetary Policy Committee (MPC) on a monthly basis. Councillors will be aware that the base rate was at its lowest level ever for a large part of 2009/10, hence the relatively limited investment returns when compared to previous years.

18. Overall, the Council achieved a return on investments of 2.22%. This compares favourably to both the average 7 day (uncompounded) LIBID return of 0.421% and the 3 month (uncompounded) LIBID return of 0.725%, both of which are the standard comparators for internally managed funds. As indicated above, this is mainly due to the amount of surplus cash available during the year but it should also be noted that the Council benefitted from investment decisions taken in 2008/09. In particular, one investment to Anglo Irish Bank returned interest at 6.15% for the year, well above the average return for the whole portfolio.

Prudential Indicators and Compliance Issues

19. The Council is required by the Prudential Code (for Capital Finance in Local Authorities) to report the actual prudential indicators after the year end. Certain of these indicators provide either an overview or a limit on treasury activity, and these are shown below in Table 2 below:-

Table 2: Net Borrowing and Capital Financing Requirement 2009/10

	2009/10 Budget Indicator £000	2009/10 Outturn Indicator*1*2 £000	Change £000
Net Borrowing/(Investment) position	(954)	+609	+1,563
Capital Financing Requirement – 31st March	+13,877	+10,560	(3,317)

*1 – Comprises long term debt of £9.109m less investments of £8.500m
*2 – The Capital Financing Requirement Outturn is provisional at this stage pending the audit of the Council's accounts

20. The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, and this is a gauge for the Council's debt position shown above.

21. There is a fundamental requirement that the Council only borrow for the purposes of capital expenditure (and not revenue expenditure). To ensure that over the medium term borrowing net of investments will only be for a capital expenditure, net borrowing should not, except in the short term, exceed the CFR. As table 2 indicates, the CFR at 31st March 2010 is £10.560m and is significantly in excess of Net Borrowing.

22. Ensuring that actual external debt remains affordable, prudent and sustainable by the Council is a fundamental requirement of the Prudential Code which requires the Council to establish an Authorised Limit and an Operational Boundary for the overall quantum of actual debt. The Authorised Limit is the "Affordable Borrowing Limit" required by s3 of the Local Government Act 2003. 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 are acceptable subject to the Authorised Limit not being breached.

23. Table 3 below shows the Council's gross borrowing position at 31st March 2010 compared to both the Authorised Limit and the Operational Boundary:-

Table 3: Performance Against Authorised Limit and Operational Boundary

	2009/10 Outturn Indicator £M
Authorised Limit	12.0
Operational Boundary	10.0
Actual Gross Borrowing Position	9.1

24. While table 3 above shows the year-end position, provided at **Appendix A** is a graph that shows performance against the limits for 2009/10 as a whole. As **Appendix A** indicates, on various occasions during the year, the Council exceeded the operational boundary by varying amounts as part of the overall cashflow strategy. Under the Prudential Code for Capital Finance in Local Authorities, it is permissible for the occasional, but not sustained, breaches in the operational boundary as was the case in during 2009/10. At no time did the Council exceed the Authorised Limit and therefore the Council did comply with the prudential limits for external debt during 2009/10.

Banking Facilities

25. The Council currently obtains its banking facilities from Lloyds TSB Bank Plc. The cost of the contract with Lloyds in 2009/10 was £15,356 which was broadly in line with budget.

26. During the year, periodic meetings were held with Bank officials to discuss issues of mutual interest and these are ongoing. The service provided by Lloyds TSB Bank Plc includes an overdraft facility of £500,000.

27. Regular monitoring is undertaken of the Council's cash balances with a particular focus on ensuring that all surplus cash is, where possible, invested in accordance with the Council's Annual Investment Strategy. As a target, the Council has previously aimed to have an average cash balance in the range of +/-£50k. However, given the significant reduction in the base rate, and consequent reduction in investment rates, on occasion it has been more cost effective to retain surplus cash in the current account. This is reflected in the variations in current account balance as shown at **Appendix F**

External Advisors

28. The Council retained Sector Treasury Services as its treasury management advisors at a cost of c£8kpa for 2009/10.

29. Regular meetings were held with Sector to assess the Council's progress in relation to the Treasury Management Strategy. In addition to daily advice on issues such as PWLB Rates, Sector provides the Council with a regular stream of information on treasury management and capital financial issues. Sector also assist the Council with:-

   - the preparation and review of the Annual Treasury Management Strategy;
   - advice on Treasury Management Practice notes and associated Schedules; and
   - monthly reviews of the Counterparty lending list in the light of the changes to investment regulations.

30. There are no matters of concern to report with the current arrangement with Sector although the level of service provided will continue to remain under review.

Appendices

Appendix A -	Economic Commentary 2009/10
Appendix B -	Analysis of Long/Short Term Borrowing compared to Borrowing Limits 2009/10
Appendix C -	Maturity Structure of current long term debt
Appendix D -	Investment Returns 2009/10
Appendix E -	Investment Balances 2009/10
Appendix F -	Daily Cashflow Balances 2009/10

Economic Commentary 2009/10

1. 2008 was a momentous year when one financial institution after another in America either collapsed or was taken over in the wake of the credit crunch, culminating in the catastrophic failure of Lehman's Brothers in September 2008 which then triggered in October the collapse of the Icelandic banks and the near collapse of three major UK banks. These three banks then needed another round of major Government support in January 2009. This prolonged financial shock to the core of the world's financial systems caused a worldwide recession to gather in pace and intensity during 2009/10 which dragged the UK economy down into its deepest and longest recession for many years.

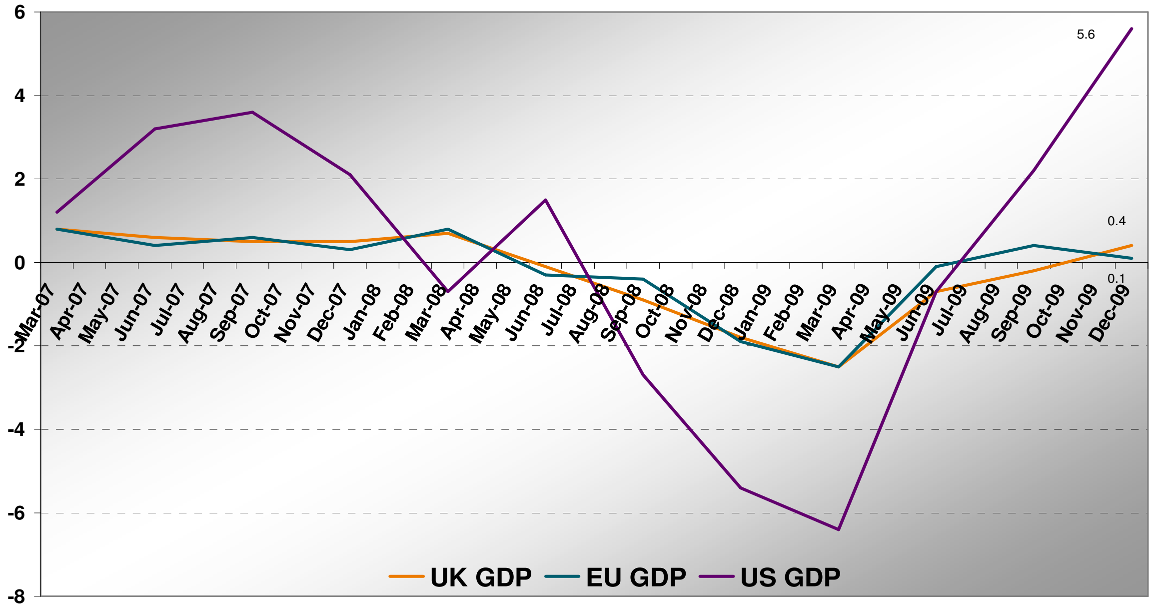
2. During the autumn of 2008, the Monetary Policy Committee (MPC) had been preoccupied with the alarming escalation of the rate of inflation propelled by earlier increases in the price of oil, commodities and energy. Inflation peaked in September 2008 on CPI at 5.2%, way over the target rate of 2%. However, the MPC soon had to radically change course as it became ever clearer that inflation would rapidly decline as the credit crunch would plunge world economies into a major recession. An unprecedented cut of 1.5% in Bank Rate in November 2008 was followed by a 1% cut in December 2008 to 2.0% and then further cuts of 0.5% each month until 0.5% was reached in March 2009.

3. The 2009/10 financial year started 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 anxiety as to how or when recovery would take place. However, even the precipitous slashing of Bank Rate before the beginning of the year was unable to make much impact on the rate at which the economy was falling headlong into recession. Consequently, in March 2009 the MPC resorted to starting a programme of quantitative easing to pump liquidity into the economy in order to stimulate growth, by purchasing gilts and corporate bonds; this had the effect of boosting their prices and therefore reducing yields, so also lowering borrowing costs for both the corporate and public sectors.

4. This programme of quantitative easing was progressively expanded during 2009 until it reached a total of £200bn of purchases in November. For the rest of the financial year, the MPC adopted a cautious approach of leaving further quantitative easing on hold in case growth in the economy needed further support. It was notable that the increase in money supply in the economy generated by this programme brought the credit crunch induced spread between Bank Rate and 3 month LIBID (investment rate that depositors could earn) down from 0.95% at the beginning of the financial year to zero during August 2009. Bank Rate itself remained unchanged at 0.5% all year.

5. The dominant focus in 2009/10 was on quarterly GDP growth figures. As can be seen from the graph below, the recession in the UK bottomed out in quarter 1 of 2009. There was major disappointment that the end of the recession failed to materialise in Q3 2009 and the first figure issued for Q4 2009 was a further huge disappointment at only +0.1%. However, subsequent revisions saw that revised upwards to first +0.3% and then +0.4%.

GDP % quarter / quarter



6. Inflation has not been a major concern of the MPC during the year as it fell back below the 2% target level from June to November. However, it did spike upwards to reach 3.5% on the back of the unwinding of the temporary cut in VAT to 15% on 1 January 2010. This was not seen as a cause for alarm as this spike would fall out of the inflation index after one year and inflation was forecast by the Bank of England to fall back below target by the end of 2010 and to stay below 2% during 2011 and 2012 due to the large amount of surplus capacity in the economy which would keep wage inflation well damped down.

7. The year was marked by a tussle between two opposing outlooks in the financial markets. The pessimists expect weak UK growth, or even a double-dip recession, to depress economic activity and hence corporate profits and share prices, so causing gilt prices to rise and long term gilt yields and PWLB borrowing rates to therefore linger at historically low levels for a prolonged period.

8. On the other hand, the optimists expect a lively return to growth in the UK led by a rebalancing of the economy resulting from increased exports driven by rapid recovery in the US, EU and the rest of the world. This would boost corporate profits and share prices and so depress gilt prices, hence causing long term gilt yields to rise to much higher levels which would then be under pinned by major concerns about the total level of debt issuance by the Government to finance the annual deficit. Accordingly, there have been fluctuations in rates during the year as first one camp and then the other gained ascendancy.

9. The financial year ended with markets gradually gaining in confidence and optimism that the economy was indeed on the path to recovery, although it appeared to be fragile, and with some residual risk that there could still be a double-dip recession. This optimism was further enhanced by a return to strong economic growth in the US towards the end of 2009. The year also saw a major resurgence in share prices in the US, UK and Europe from a very depressed level in March 2009 on the back of this rise in optimism.

10. There were concerns in the US and UK that consumers would be reluctant to spend as they would be focusing on reducing their bloated levels of debt and would struggle to pay mortgages when they end their short term discounted rates at a time when switching mortgages to cheaper rates is still not a readily available option. Consumers were also mindful of the increases in taxation coming up and the threat to jobs from impending public sector reductions in expenditure. The UK needs to see strong growth in the EU, its major trading partner, in order for the UK economy to rebalance its economy towards export led growth. However, the continuing reluctance of EU consumers to spend leaves an uncomfortable question mark in this area.

11. On the positive side, the supply of credit had improved considerably during the year and the credit crunch induced spread between Bank Rate and 3 month LIBID had evaporated. The equity market ended in buoyant mode with shares being at their highest level for nearly two years. The reverse side of this coin though was that gilt prices had fallen and long term yields (and so PWLB long term borrowing rates) were getting near to their peak for the year. The bond markets ended the year with chronic fears about a possible Greek government debt default and commentators were remarking that both Greece and the UK were running similar size annual deficits as a percentage of GDP (expected to be over 12%). However, the UK was in a much stronger position than Greece e.g. due to its much lower level of total debt. However, there were frequent comments from credit rating agencies around a possible threat that the UK government could lose its AAA credit rating if after the general election there was not a credible plan for how the promised reductions in the annual budget deficit would actually be achieved.