Meeting:	Cabinet
Date:	17 December 2009
Subject:	Half Year 2009/10 Treasury Management Activity
Key Decision:	No
Responsible Officer:	Myfanwy Barrett: Corporate Director Finance
Portfolio Holder:	Councillor David Ashton (Leader and Portfolio Holder for Strategy, Partnership and Finance)
Exempt:	No
Enclosures:	Nil

Section 1 – Summary and Recommendations

This report sets out a half year summary of Treasury Management activities for 2009/10.

Recommendation
Note the half year treasury management activity for 2009/10.

Reason
To keep Cabinet Members informed of Treasury Management activities and performance.

Section 2 – Report

<u>Introduction</u>

1. The Council approved a Treasury Management Strategy for 2009/10 in February 2009, which complies with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management and Prudential Code for Capital Finance.

2. The Chartered Institute of Public Finance and Accountancy are issuing a new Treasury Management code in December 2009. The new code will

be incorporated in the Treasury Management Strategy for 2010/11 which will be reported to the Cabinet in February 2010.

3. The overall objective of Treasury Management is to manage the Council's cash flow, borrowing and investments, and to control the associated risks, so as to maintain liquidity, maximise the return on investments and to minimise charges on loan debt with minimal risk to the Council's assets.

4. This report is the half year summary of performance on treasury management activities to 30 September 2009 and covers:
   - the half year forecast outturn position;
   - the economy in first half of 2009/10;
   - the Treasury Management activity for the period ending 30 September 2009; and
   - compliance with Prudential Indicators.

Forecast outturn Position

5. There is a forecast net surplus of £1.280m on the capital financing and investment income budget as detailed in the table below:

	Latest Budget	Forecast Outturn	Variation	
	£000	£000	£000	%
Cost of Borrowing	8,664	7,396	-1,268	-14.6
Investment Income	-268	-916	-648	-241.8
Minimum Revenue Provision	8,695	9,331	636	7.3
Total	**17,091**	**15,811**	**-1,280**	**-7.5**

6. The main reasons for the variations are :
   - Borrowing cost – under spend of £1.268m reflects the underlying under spends identified as part of the 2008/09 outturn;
   - Investment income – over achievement of income amounting to £0.648m mainly due to higher cash balances and better returns than originally budgeted; and
   - MRP overspend of £0.636m is a result of more projects completed in 2008/09 than budgeted.

The Economy and Interest Rates

7. The second quarter of 2009 saw:
   - Some signs of recovery in the market, with some sectors showing growth;
   - Concerns remained about the fragile state of any recovery with the impact of rising unemployment, therefore bank rate/investment rates expected to stay lower for longer;
   - House prices rose at the fastest rate in over five years;
   - An extension of the Bank of England's quantitative easing programme at its recent meeting in November by £25bn bringing the total to £200bn. However, to date this has had limited success in boosting credit or money supply growth;
   - Unemployment continued to rise and pay growth weakened further;

- Inflationary pressures in the economy eased further, but more slowly than had been expected;
- Conditions in financial markets improved further, and equity prices rallied strongly;
- The pound fell back, yielding much of the gains made in the first quarter; and
- Other major economies showed signs of making an exit from the recession.

8. The Council's Treasury Advisers, Sector, provides the following forecast of bank base rate and PWLB borrowing rates:

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Bank rate	0.50%	0.50%	0.50%	0.75%	1.25%	1.75%	2.50%	3.00%	3.75%	4.00%	4.25%	4.50%	4.50%	4.50%
5yr PWLB rate	2.80%	2.90%	3.10%	3.20%	3.30%	3.55%	3.85%	4.15%	4.55%	4.60%	4.80%	4.80%	4.85%	4.85%
10yr PWLB rate	3.75%	3.80%	3.90%	4.00%	4.15%	4.30%	4.55%	4.75%	4.95%	5.00%	5.10%	5.15%	5.15%	5.15%
25yr PWLB rate	4.35%	4.45%	4.55%	4.60%	4.70%	4.90%	5.00%	5.00%	5.10%	5.20%	5.30%	5.30%	5.35%	5.35%
50yr PWLB rate	4.50%	4.55%	4.70%	4.75%	4.90%	5.00%	5.15%	5.15%	5.20%	5.25%	5.40%	5.40%	5.45%	5.45%

9. Based on the above forecast the first base rate increase is expected to be in Q2 of 2010/11 increasing to 4.5% in Q2 of 2012/13. Long term PWLB rates to steadily increase to reach 5.45% by the end of 2012 due to high gilt issuance, reversal of QE and investor concerns over inflation.

Treasury Management Activity for the period ending 30 September 09

10. The Council's debt and investment position as at 30 September was as follows:

	31st March 2009	Average Rate	Average Life yrs	30 Sept 2009	AverageR ate	Average Life yrs
	£M	%	Yrs	£M	%	Yrs
Fixed Rate Funding						
- PWLB	135.4	4.38	33.33	135.4	4.38	33.33
- Market	81.8	5.18	34.63	81.8	5.18	34.63
Total Debt	**217.2**	**4.69**		**217.2**	**4.69**	
Investments:						
- In-House	84.9	5.26		102.8	1.74	
Total Investments	**84.9**			**102.8**		

Investments

11. The Council manages its investments in-house and invests with the institutions listed in the Council's approved lending list. The Council invests for a range of periods from overnight to 364 days / 5Y years, dependent on the Council's cash flows, its interest rate view and the interest rates on offer.

12. A total of £102.8m investments were placed via the London money market as at 30 September 2009. The average forecast return is expected to be approximately 1.74%. This figure compares favourably with the average 7 day LIBOR rate for the first half of the year at 0.56%.

13. Following the credit crunch in 2008, the credit criteria and counter party lists were reviewed in December 2008. This resulted in removing all the building

societies from the list except for the ones which were credit rated and met the minimum criteria. This has resulted in decline in investments with the building societies from £73.9m in September 2008 to £38.0m in September 2009.

14. The table below sets out the position as at 30 September 2009.

	2008/09				2009/10	
	Sept 2008		March 2009		Sept 2009	
	£m	%	£m	%	£m	%
Specified Investments						
Banks	9.7	10.6	52.8	62.2	50.7	49.3
Money Market Funds	7.8	8.5	5.0	5.9	14.1	13.7
Non –Specified Investments						
Building Societies	73.9	80.9	27.0	31.9	38.0	37.0
Total	91.4	100.0	84.9	100.0	102.8	100.0

15. Investing for periods longer than 365 days - The Council also aims to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, and only invest with highly credit rated financial institutions. During the period £3m was invested for 18 months with Royal Bank of Scotland to take advantage of the higher rate that was on offer.

16. In January 2009 Fitch downgraded Irish banks and therefore all the Irish banks were removed from the counter party list. Based on the advice from our advisors following on from the deteriorating economy, a decision was taken on 31st March 2009 to withdraw monies from both Bank of Ireland and Allied Irish Bank. A total sum of £12.8m was withdrawn on 01st April 09, with a breakage cost of approximately £0.075m.

Long Term Borrowing

17. The Authorised Limit and Operational Boundary for External Debt are £311m and £288m respectively.

18. In order to fund the capital programme and to take advantage of the lower interests rates, the Treasury Management Group decided based on the advice received from Sector to borrow £20m Lender Option Borrower Option (LOBOs) for a period of 50 years in July (£10m at 4.3%) and October (£10m at 3.65%) respectively with the drawdown date in February 2010.

19. Total long term debt of £217.2m at September 2009 is made up £81.8m Bank loans and £135.4m PWLB loans.

	Upper Limit	Lower Limit	Actual 30 September 2009	
	%	%	£m	%
Under 12 Months	20	0	5.02	2.31
12 Months and under 24 Months	20	0	0.02	0.01
24 Months and within 5 years	30	0	10.15	4.67

5 years and within 10 years	40	10	26.09	12.01
10 years and above	95	30	175.89	81.0
Total			217.17	100.00

Prudential Indicators

Capital Expenditure

20. The original capital investment plan for 2009/10 reported to Cabinet in February 2009 was £61m. This has increased by £58m as detailed below:
    - Capital projects of £33.343m brought forward from 2008/09 of which £12.8m is funded by borrowing; and
    - £24.777m mainly due to additions of new schemes which are mostly grant funded.

	Original Capital Programme			Revised Capital Programme		
	GF	HRA	Total	GF	HRA	Total
	£000	£000	£000	£000	£000	£000
Total Programme	**54,046**	**7,000**	**61,046**	**106,152**	**13,014**	**119,166**
Funding						
Grant	22,531		22,531	67,685		67,685
Capital Receipt/Revenue Contribution		4,028	4,028	884	4,028	4,912
Borrowing	31,515	2,972	34,487	37,583	8,986	46,569
Total Funding	**54,046**	**7,000**	**61,046**	**106,152**	**13,014**	**119,166**

Capital Financing Requirement

21. The forecast position on the Capital Financing Requirement for the HRA has increased by £7.4m mainly due to the increase in the capital programme to meet the decent home standards.

31 March	**2009**		**2010**	
	£000	**£000**	**£000**	**£000**
	Estimate	**Actual**	**Estimate**	**Forecast**
General Fund	198,781	196,536	221,503	221,211
HRA	47,161	47,580	49,130	56,566

<u>Ratio of financing Costs to Net Revenue Stream</u>

22. The financing costs of the council include interest payable in respect of borrowing, premiums paid and the minimum revenue provision. Netted off against these expenses is interest earned on investments and discounts received on debt restructuring.

	2008/09		**2009/10**	
	Estimate	**Actual**	**Estimate**	**Forecast**
	%	**%**	**%**	**%**
General Fund	6.61	5.67	10.14	9.36
HRA	35.64	35.46	38.55	38.07

FINANCIAL IMPLICATIONS

23. Financial matters are integral to the report.

PERFORMANCE ISSUES

24. Treasury Management is scored as part of one of the Key Lines of Enquiry on Managing Finances in the Use of Resources framework. The Council meets the requirement of the CIPFA Code of Practice for Treasury Management and therefore is able to demonstrate best practice for the Treasury Management function, contributing to the overall score on the Use of Resources.

ENVIRONMENTAL IMPACT

25. There is no environmental impact.

RISK MANAGEMENT IMPLICATIONS

26. Under the current economic climate there is a risk that the Council could lose its deposits due to failure of a counter party.

    Risk included on Directorate risk register? Yes
    Separate risk register in place? No

Section 3 - Statutory Officer Clearance

Name: Jennifer Hydari Date: 20 November 2009	√	On Behalf of the Chief Financial Officer
Name: Jessica Farmer Date: 19 November 2009	√	On Behalf of the Monitoring Officer

Section 4 – Performance Officer Clearance

Name: Alex Dewsnap Date: 20 November 2009	√	Divisional Director Partnership Development and Performance

Section 5 – Environmental Impact Officer Clearance

Name: John Edwards Date: 19 November 2009	√	Divisional Director Environmental Services

Section 6: Contact details and background papers

Contact: Jennifer Hydari (Divisional Director of Finance and Procurement tel: 020-8424-1393)

Background Papers: Report to February 2009 Cabinet