



CABINET REPORT

Report Title	TREASURY MANAGEMENT OUTTURN 2008-09
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AGENDA STATUS: PUBLIC

Cabinet Meeting Date:	23 September 2009
Key Decision:	NO
Listed on Forward Plan:	YES
Within Policy:	YES
Policy Document:	NO
Directorate:	Finance & Support
Accountable Cabinet Member:	David Perkins
Ward(s)	Not Applicable

1. Purpose

- 1.1 To inform the Cabinet of the Council's performance in relation to its borrowing and investment strategy for 2008-09.
- 1.2 To advise Cabinet of an increase in 2009-10, authorised by the Chief Finance Officer, to the maximum amounts permitted for investments with the UK Debt Management Office and with the UK nationalised/part nationalised banking groups.

2. Recommendations

- 2.1 That the Cabinet recommend to Council that they note the Council's Treasury Management Performance in 2008-09.
- 2.2 That Cabinet note the following changes to 2009-10 counterparty limits, authorised by the Chief Finance Officer (the Section 151 Officer), on 12 June 2009:

- An increase in the maximum level of investment with any counterparty, or group of counterparties from £10m to £15m.
- That under the additional restrictions to counterparty criteria and limits in place for 2009-10 set out in the Treasury Strategy, the increased limit should apply only to the maximum amounts permitted for investments with the UK Debt Management Office and with the UK nationalised/part nationalised banking groups included on the Sector list (Lloyds Banking Group, Royal Bank of Scotland Group and Northern Rock).

3. Issues and Choices

Background

- 3.1 The Council adopted the CIPFA Code of Practice for Treasury Management in the Public Services ("the Code of Practice") following its publication in 2001. This was formally minuted as a decision at the Council meeting of 21 January 2008.
- 3.2 The Code of Practice recommends that a report covering the relevant activities of the preceding financial year be submitted annually to the Council by 30 September of each year.

Accounting & Audit Issues

- 3.3 The 2008 CIPFA Statement of Recommended Practice (2008 SORP) includes a complex set of regulations on accounting for financial instruments. These requirements have been fully complied with in the preparation of the Council's Statement of Accounts.
- 3.4 The regulations include the values at which financial instruments, including borrowing and investments, should be calculated for inclusion on the balance sheet at year-end. In some instances this is at amortised cost, whereby the balance sheet value is written up or down via the income and expenditure account over the life of the instrument to reflect costs or benefits, such as transaction costs or interest earned or due to date.
- 3.5 In summary, and broadly speaking, the balance sheet values of the Council's debt and investments at 31 March 2009 are held as follows:

Borrowing (Financial Liabilities)	
Long term borrowing	Amortised cost
Short term borrowing	Original (cash) value
Investments (Financial Assets)	
Deposit and call accounts	Original (cash) value
Short term money market investments	Amortised cost

- 3.6 All outturn figures contained in this report are subject to external scrutiny, through the annual audit of the Council's Statement of Accounts.

Economic Environment

- 3.7 2008-09 was a year of rapid economic downturn and unprecedented deterioration in the stability of the worldwide and UK banking sector. The financial crisis, commonly known as the 'credit crunch', has had major impacts at all levels of the economy both nationally and across the globe.
- 3.8 The origins and economic impact of the credit crunch have been widely documented and reported on. The first major widespread impact on the local authority treasury function was the collapse of the Icelandic banking system in early October 2008. Northampton Borough Council did not hold any Icelandic bank deposits; however those local authorities that did have funds invested with these banks are still waiting to find out how much of their investments they might recover.
- 3.9 In the last two quarters of the year financial institutions of all sizes around the world saw their credit ratings slashed. This has included the downgrading of sovereign ratings, most notably in the Republic of Ireland.
- 3.10 The Monetary Policy Committee (MPC) has followed the traditional method of monetary easing by cutting interest rates, but on a scale not seen before. In March 2009 the Bank of England announced that it would accompany the rate cuts with a policy of quantitative easing aimed at getting more cash liquidity into the economy.
- 3.11 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.
- 3.12 Local authority financial regulatory bodies such as the Audit Commission and CIPFA have reacted to these external events, and most specifically to the impact on local authorities of the Icelandic banks collapse. There has been rigorous scrutiny of treasury management governance and processes; for

example, in March 2009, the Audit Commission produced a cross cutting national report, "Risk and Return", on English local authorities and the Icelandic banks.

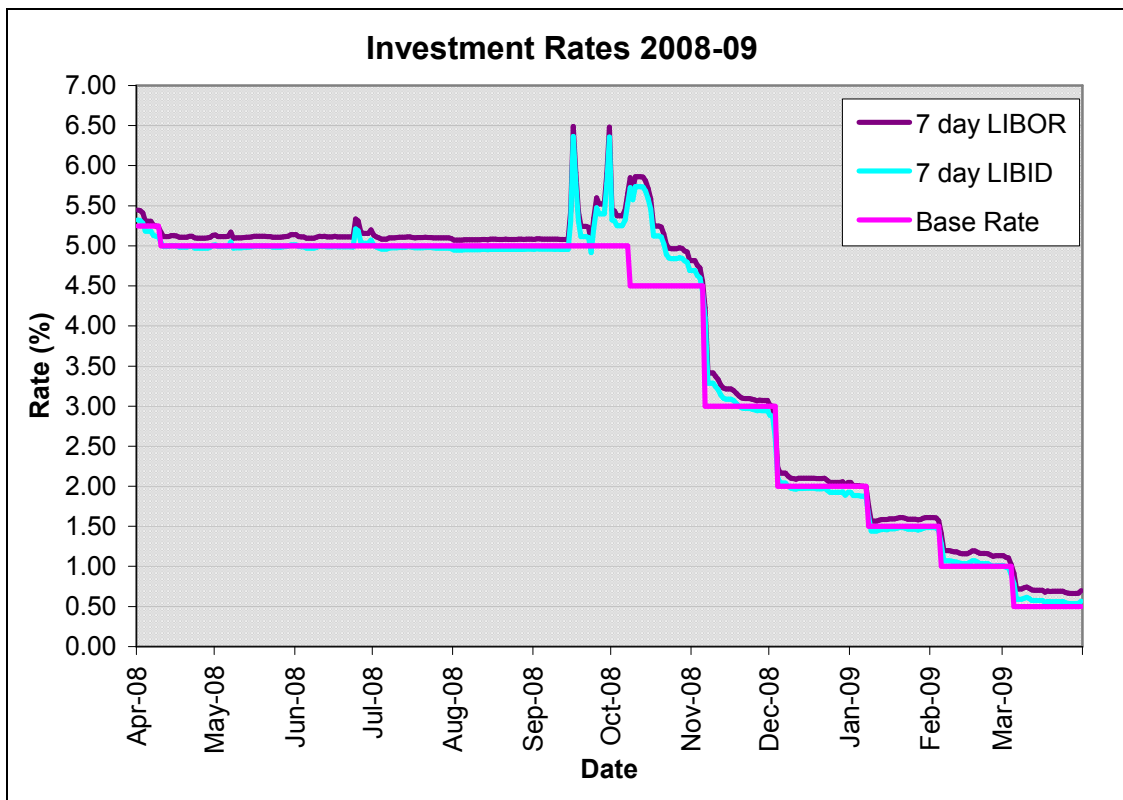
- 3.13 Recommendations on improvements in local authority treasury management governance and practices continue to emerge. The CLG Select Committee report on Local Authority Investments issued on 11 June calls for a number of changes to the way in which the treasury management function is managed, and CIPFA's Treasury Management Panel are undertaking a revision of the Treasury Management Code of Practice. The Council's treasury management processes are being reviewed during 2009-10 in the light of external recommendations as they develop.

Interest Rates

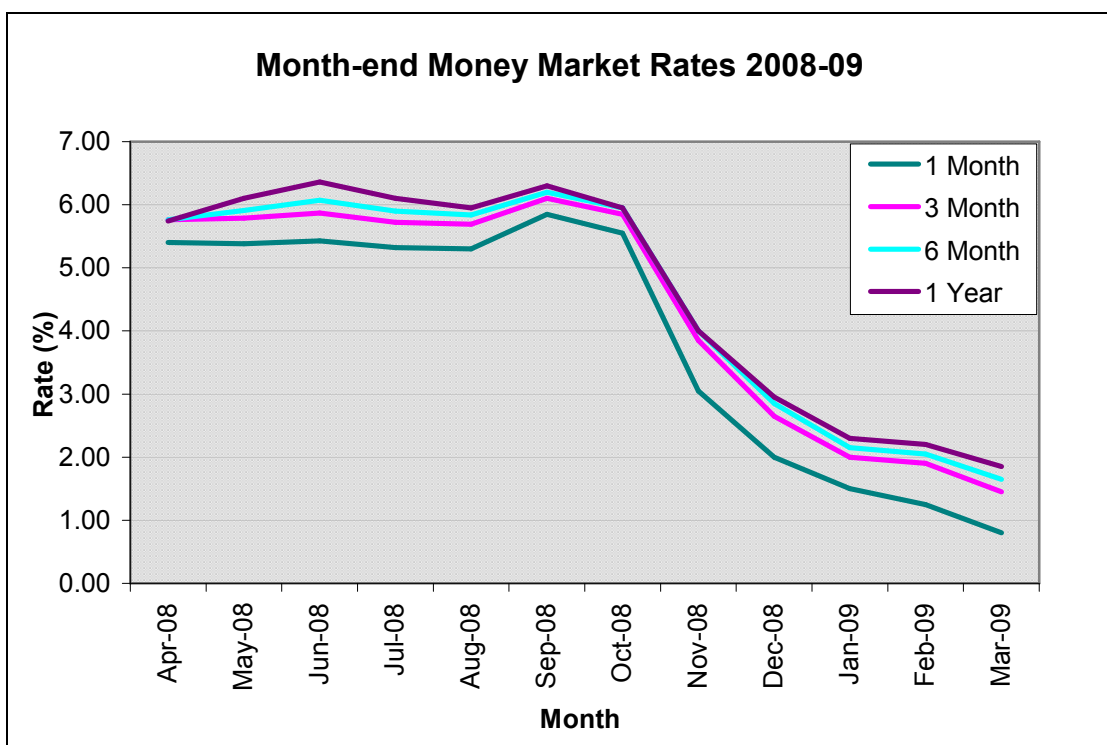
- 3.14 Definitions of key terms used are set out below.

Bank Of England Base Rate	The interest rate at which the Bank of England lends to financial institutions. This affects interest rates set by commercial banks, building societies and other institutions. Lowering or raising interest rates affects spending in the economy. A reduction in interest rates makes saving less attractive and borrowing more attractive, which stimulates spending. The opposite occurs when interest rates are increased.
Libor Rate	The London Interbank <i>Offered</i> Rate is based on the average rate at which banks offer to <i>lend</i> to other banks.
Libid Rate	The London Interbank <i>Bid</i> Rate is the rate bid by banks on Eurocurrency deposits, i.e., the rate at which a bank is willing to <i>borrow</i> from other banks.

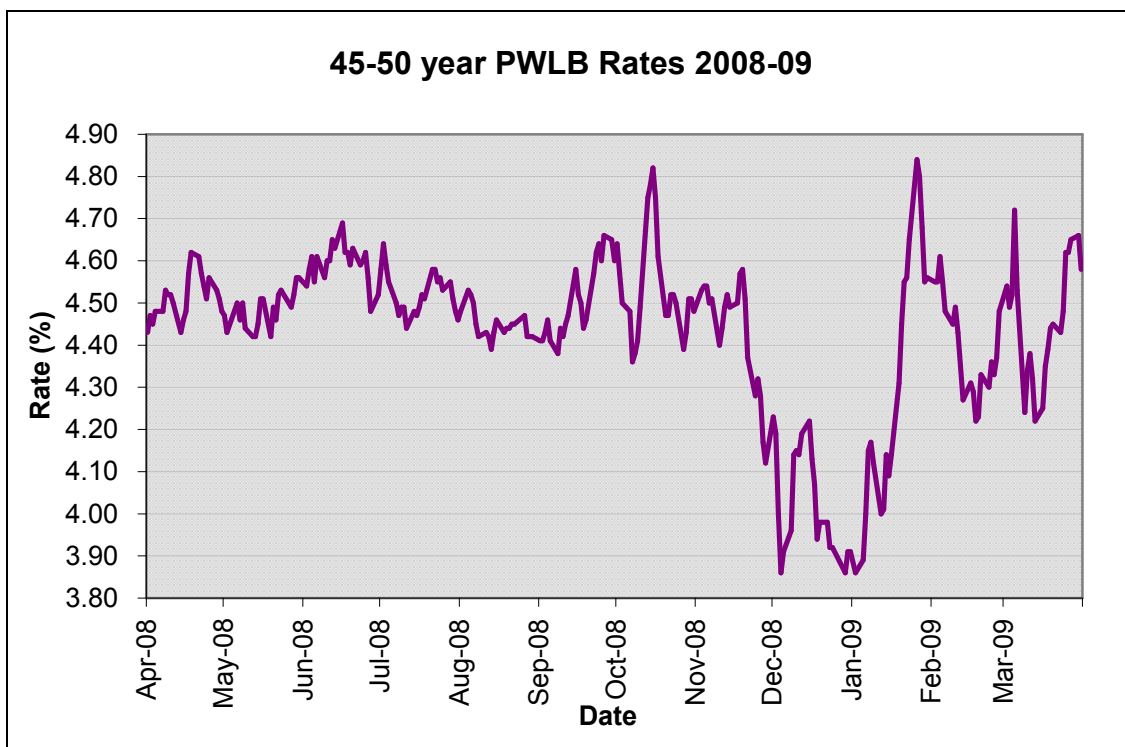
- 3.15 Interest rates were closely monitored during the course of the year. The bank base rate for 2008-09 started at 5.25%, falling to 5.0% on 10 April 2008. This rate was maintained until October 2008, when it was reduced to 4.5%. Subsequently the monetary easing policy followed by the MPC led to monthly cuts, ending with a low of 0.5% by March 2009. This trend was approximately followed by the average 7 day London Interbank Bid Rate (LIBID), and the average 7 day London Interbank Offered Rate (LIBOR). This is illustrated in the graph below.



- 3.16 Investment rates remained fairly stable in the first half of the financial year; in the second six months they continued to broadly follow the line of the bank base rate, LIBID and LIBOR rates through their steep decline to their year-end positions. At the year-end, one-month investment rates fell more sharply than longer-term rates, making it more advantageous to use deposit accounts, which were offering better rates, where longer-term investments were not suitable in order to maintain appropriate levels of liquidity.



- 3.17 Long-term interest rates applicable to borrowing decisions can be illustrated by the Public Works Loan Board (PWLB) 45-50 year rate. This started the year at 4.43%, fell to a low of 3.86% in December, and then rose to a high of 4.84% in January, ending the year at 4.58%. The rates are set out in the graph below.



Borrowing

3.18 Long Term Borrowing

- a) Annex A shows the Council's long term debt as at 31 March 2009 at amortised cost. The total debt outstanding, at amortised cost, is £26m. Of this amount, 95.2% (£24.8m) is in the form of money market LOBO loans, and the remaining balance of 4.8% (£1.2m) in the form of an annuity with Homes and Communities Association (HCA) (formerly English Partnerships).

No loans were repaid during the year other than the repayment of the principal element of the annuity with HCA (£13k) due in 2008-09. The principal amount due to HCA in 2009-10 (£14k) has been transferred to a current creditor, and is not included in the borrowing figures above and at Annex A.

No new borrowing or rescheduling of loans took place during the financial year.

- b) Under Section 3 of the Local Government Act 2003, the Council is required to set an annual affordable borrowing limit. This limit is also set as a prudential indicator – i.e. the authorised borrowing limit. The affordable borrowing limit for 2008-09 was set by Council at its meeting on 28 February 2008.

Compliance is demonstrated below:

	Affordable Borrowing Limit as set 28 February 2008	Maximum Actual Amount Outstanding in Year
Overall Borrowing	£43m	£26m

- c) Annex B illustrates the Council's long-term debt maturity profile as at 31st March 2009.

Officers will be looking, during 2009-10, at options to manage the rescheduling or repayment of LOBO loans of £15.6m currently due for repayment in 2014-15.

3.19 Short Term Borrowing

- a) The Council has long-standing agreements with two local organisations, Billing Parish Council and Northampton Volunteering Centre, for the short-term deposit of funds with the Council. Accounting regulations require that these be treated in the accounts as short-term borrowing.

The interest rate applied to these deposits in 2008-09 was linked to the Bank of England lending rate.

Formal agreements have been set up with these two organisations from 1 April 2009 whereby the interest rate is set quarterly using the Council's average investment rate for the previous quarter, less 0.5% to cover administration costs.

The year-end position on temporary borrowing, and the range of rates applied, is set out at Annex C.

Investments

3.20 Investments Strategy

- a) The ODPM (now CLG) Guidance on Local Government Investments, issued in March 2004, requires Councils to set an Investments Strategy covering types of investment, liquidity issues, interest rates and prudential indicators. The Council's Investment Strategy for 2008-09 was included in the Treasury Strategy for 2008-09, approved by Council at its meeting on 28 February 2008.

b) Investments are split into 2 categories:

- (i) Specified investments which are broadly sterling investments, not exceeding 364 days and with a high credit rating; and
- (ii) Non-specified investments that do not satisfy the conditions for specified investments.

The Council's Investment Strategy for 2008-09 set out the Council's credit rating criteria for specified investments, and the types of unspecified investments that it might enter into, including investments over 364 days.

The Council's Investment Strategy was revised during the year, following the collapse of the Icelandic banks, in recognition of the changed investment and banking environment. A significantly reduced counterparty list was drawn up at this time. This was subsequently amended to incorporate a more sophisticated methodology for managing the Council's investment risk. It continues to be very closely monitored and managed.

Money market investments made during the year, analysed by value, comprised 97% specified investments and 3% unspecified investments, the latter being investments over 364 days.

- c) The total value of investments held at 31st March 2009, at amortised cost for money market investments and cash values for deposit accounts, was £53m. All investments were placed with reference to a pre-determined lending list, in line with the investment strategy.

Investment Type	Balance at 31 March 2009 £m
Building Societies	9.959
Cash on Deposit	11.280
Banks under 1 year	46.716
Banks over 1 year	6.303
Total	53.019

- d) During the preceding financial year, 2007-08, the Council increased its use of deposit accounts in order to more pro-actively manage core cash balances to maximise returns whilst maintaining liquidity. Use of these accounts increased further during 2008-09 and balances in deposit accounts at year-end were £11.3m, representing 21% of the overall investment portfolio.

- e) The Council held a debenture of £100k with the Association of District Councils (Properties) Ltd (ADCP). The property to which the debenture related was sold by ADCP on 1st April 2008, and the debenture was repaid to the Council with interest on 31st July 2008.
- f) The Council does not hold any financial instruments listed or publicly traded on a stock exchange.
- g) Most short term investments are held for cashflow purposes. The average period of investments in the year (excluding instant access deposit accounts) was 99 days. The range was from 2 days to 730 days (2 years).
- h) Annex D analyses the Council's performance on investment returns by plotting the Council's average monthly investment rate achieved against the average 7 day London Interbank Bid Rate (LIBID), and the average 7 day London Interbank Offer Rate (LIBOR). The average rate achieved was 5.24% compared to 3.68% LIBID, and 3.80% LIBOR. Medium term investments entered into earlier in the year when rates were high enabled the Council to achieve a significant differential in the second half of the year.
- i) However the sea change in the external economic and investment environment during 2008-09 means that in the latter part of 2008-09 investment returns achieved were significantly reduced compared with previous years, and this trend has continued going forward into 2009-10. This is not only due to the very low interest rates available generally, but also reflects the need to protect investment capital by investing with a fewer number of quality counterparties at lower rates in an inherently risky market.
- j) Outturn information on the Prudential Indicators relating to treasury management is shown in Annex E.

Debt Financing Budget Outturn

3.21 Annex F shows the costs of financing and managing the Council's debt and investment portfolio in 2008-09. A summary is set out below:

Budget Comparison	Approved Budget 2008-09 £000	Outturn 2008-09 £000	Variance 2008-09 £000
Debt Financing & Interest	146	(641)	(787)
Debt Management	112	105	(7)
Total	257	(536)	(794)

3.22 The most significant reasons for the variances are as follows:

Explanation	Variance 2008-09 £000
Overachievement of investment interest against budget, due to the impact of favourable investment rates in the early part of the financial year combined with more pro-active management of the Council's investments to achieve optimum returns. A proportion of the overall savings were transferred to the HRA to recognise interest earned on HRA balances	(332)
Budgeted new borrowing not undertaken. Capital expenditure funded by borrowing in 2008-09 has been financed through cash flow rather than actual borrowing.	(154)
Reversal of interest accrued since 1987 on a developer deposit that is now to be retained by the Council subsequent to the dissolution of the company in 1999.	(146)
Minimum Revenue provision (MRP) is based on the opening capital financing requirement of the authority. The actual provision required was less than budgeted due to slippage on 2007-08 capital programme.	(102)

- 3.23 The debt-financing budget is particularly exposed to risk in uncertain economic conditions and when interest rates are volatile. A portion of the budget underspend has therefore been used to create a reserve of £460k to mitigate the risk that the Council may be exposed to in 2009-10 and future years should the economic downturn and a low interest rate environment continue. Year-end movements on reserves were reported to Cabinet on 29 June 2009 in the General Fund Revenue Budget Outturn report.

Counterparty Investment Limits 2009-10

- 3.24 Policies for the management of counterparty and credit risk are set out at Section 5 of the Schedule to Treasury Management Practice 1, approved by Council on 28 Feb 2009. The following extract relates to overall maximum values:
- *The maximum value for any single investment transaction will be £5m.*
 - *The maximum level of investment with any counterparty, or group of counterparties will be £10m.*
 - *The Chief Financial Officer will have the discretion to adjust maximum lending limits should it become necessary to enable the effective management of risk in relation to investments. Any adjustments in maximum lending limits under this paragraph will be reported to Cabinet subsequently.*
- 3.25 On 12 June 2009 the Chief Financial Officer (the Section 151 Officer) authorised:
- An increase in the maximum level of investment with any counterparty, or group of counterparties from £10m to £15m.
 - That under the additional restrictions to counterparty criteria and limits in place for 2009-10 as set out in the Treasury Strategy, the increased limit should apply only to the maximum amounts permitted for investments with the UK Debt Management Office and with the UK nationalised/part nationalised banking groups on the Sector list (Lloyds Banking Group, Royal Bank of Scotland Group and Northern Rock).
- 3.26 The change was put in place to manage cash balances from maturing investments in June and July 2009 placed in the previous year with counterparties that are no longer on the Council's approved list.
- 3.27 The updated investment counterparty criteria and limits are set out at Annex G.

4. Implications (including financial implications)

4.1 Policy

4.1.1 The Council is required to set and agree the following policy and strategy documents:

- A Treasury Management Policy Statement
- Treasury Management Practices (TMPs) and TMP Schedules
- An annual Treasury Strategy incorporating:

The Capital Financing and Borrowing Strategy for the year including:

- The Council's policy on the making of Minimum Revenue Provision (MRP) for the repayment of debt, as required by the Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008.
- The Affordable Borrowing Limit for the year as required by the Local Government Act 2003.

The Investment Strategy for the year as required by the CLG (formerly ODPM) Guidance on Local Government Investments issued in 2004.

4.1.2 These documents are reported to Cabinet and Council as part of the budget setting process. The Council's Treasury Strategy for 2008-09 was approved by Council at its meeting on 28 February 2008.

4.2 Resources and Risk

4.2.1 The risk management of the treasury function is considered as an integral part of day-to-day treasury activities, and is also specifically covered in the Council's Treasury Management Practices (TMPs), which are reviewed annually.

4.2.2 Specific issues relating to treasury management risks in the current economic and banking environment are covered in the body of the report

4.3 Legal

4.3.1 The Council is obliged to carry out its treasury management activities in line with statutory requirements and associated regulations and professional guidance. The relevant legislative and regulatory documents are referred to within the report and listed in the background papers.

4.4 Equality

- 4.4.1 An Equalities Impact Assessment (EIA) was carried out on the Council's Treasury Strategy on 11 August 2008, and reported to Cabinet on 1 September 2008 with the 2007-08 Treasury Outturn report. The EIA screening process indicated that a full EIA was not required. There are no specific equalities issues or implications associated with this report.

4.5 Consultees (Internal and External)

- 4.5.1 Consultation on treasury management matters is undertaken as appropriate with the Council's treasury advisers, Sector, and with the Portfolio holder for Finance.

4.6 How the Proposals deliver Priority Outcomes

- 4.6.1 The Council is required to keep its treasury management strategy under review and monitor against it. The strategy should reflect the requirements of the CIPFA Code of Practice for Treasury Management in the Public Services.
- 4.6.2 This contributes positively to Comprehensive Area Assessment (CAA) Use of Resources requirements. This supports the Council's priority to be a well-managed organisation that puts customers at the centre of what we do.

4.7 Other Implications

- 4.7.1 No other implications have been identified.

5. Background Papers

Statute, Regulation and Guidance

CIPFA Treasury Management in the Public Services - Code of Practice and Cross-Sectoral Guidance Notes 2001

Local Government Act 2003

Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

ODPM Guidance on Local Government Investments 2004

CIPFA Treasury Management in the Public Services - Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (Fully Revised Second Edition 2006)

The Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008

CIPFA Prudential Code for Capital Finance in Local Authorities 2003

CIPFA Prudential Code for Capital Finance in Local Authorities – Fully Revised Guidance Notes for Practitioners 2007

CIPFA Code of Practice on Local Authority Accounting in the UK: Statement of Recommended Practice 2008 (SORP 2008)

CIPFA Code of Practice on Local Authority Accounting in the UK: Statement of Recommended Practice 2008. Guidance Notes for Practitioners

Audit Commission. Risk & Return: English Local Authorities and the Icelandic Banking Crisis (March 2009)

CLG Select Committee report on Local Authority Investments (11 June 2009)

Reports to Cabinet & Council

Capital Programme 2006-07 Monitoring – Report to Cabinet 3 July 2006 (*Contains the Council's Treasury Management Practices (TMPs) for 2006-07 and 2008-09*)

Prudential indicators for Capital Finance 2007-08 - Position as at 30 November 2007 - Report to Council 21 January 2008 (*Contains formal adoption of the CIPFA Code of Practice for Treasury Management*)

Treasury Management Outturn 2007-08 – Report to Cabinet 1 September 2008 & Council 29 Sept 2008 (*Contains Equalities Impact Assessment carried out on the Council's Treasury Strategy*)

Treasury Strategy 2008-09 to 2010-11 – Report to Cabinet 20 February 2008 & Council 28 February 2008

General Fund Revenue Budget Outturn Position 2008-09 – Report to Cabinet 29 June 2009

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