AGENDA ITEM NO. 6(4)

POLICY AND RESOURCES SCRUTINY COMMITTEE - 20TH JULY 2010

SUBJECT: **TREASURY MANAGEMENT & CAPITAL FINANCING PRUDENTIAL INDICATORS OUTTURN 2009/10 REPORT**

REPORT BY: **DIRECTOR OF CORPORATE SERVICES**

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1. PURPOSE OF REPORT

1.1 To present Members with details of Treasury Management activities and Capital Financing, together with the related Prudential Indicators for 2009/10.

2. SUMMARY

2.1 The Code of Practice on Treasury Management in the Public Services, which was adopted by the Council on 4th March 2004, sets out a framework of operating procedures, which is encompassed in the Treasury Management Practices (TMPs). The Council subsequently approved the detailed TMPs on 27th May 2004. TMP6 (Reporting Requirements and Management Information Arrangements) provides for the submission of monitoring reports to the appropriate committee on a quarterly basis.

2.2 Members are advised that the CIPFA have issued a new code (the 2009 Code) which will need to be formally adopted, together with updated TMPs, by the Council. It is intended to present a full report on the new code to the Committee's meeting in October.

2.3 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital Finance and Accounting)(Wales) Regulations 2003 [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

The Authority's Annual Investment Strategy and Capital Financing Prudential Indicators for 2009/10 were approved by Council on 26th February 2009.

3. LINKS TO STRATEGY

3.1 The report has links to the four basic strategic themes of the Council, taking into account cross-cutting issues where relevant. It has specific links to the effective and efficient application and use of resources.

4. THE REPORT

4.1 Treasury Management

4.1.1 Background – Interest Rates

At the time that the Strategy for 2009/10 was decided, the Bank Rate was 1.00% (from 05/02/09) with the Government concerned over the severe downturn in the global economy and its effect on the U.K, mainly recession, depression and deflation. In early March 2009, the Monetary Policy Committee announced that, in addition to setting Bank Rate at 0.5%, it would start to inject money directly into the economy in order to meet the inflation target ('quantitative easing'). Sector, along with other analysts, forecast that the level of bank rate was to be maintained throughout 2009/10 and this prediction proved to be correct.

Against this background the PWLB 45-50 year maturity rate started the year at 4.57%, falling to a low of 4.19% in early October before ending the year at 4.71%, giving an overall average for the year of 4.53%.

4.1.2 Borrowing

The Annual Strategy for 2009/10 set out that:-

- rescheduling opportunities should continue to be evaluated
- due to the level of interest rates, in particular the difference between long-term borrowing rates and short-term investment rates no new borrowing should be undertaken in 2009/10
- Internal borrowing would reduce funds available for investment, which in turn reduced risk to the Authority

4.1.3 New Borrowing

The final borrowing requirement for 2009/10 of £13.630m was made up as follows:-

- replacement of maturing PWLB loans £4.149m.
- funding of 2009/10 capital programme £9.481m.

As indicated in the previous paragraph, the difference between long-term borrowing rates and short-term investment rates resulted in the fact that it was more advantageous to use internal funding for the capital programme in lieu of borrowing, this strategy also reduced risk in respect of the size of the investment portfolio. Consequently, no new borrowing was undertaken in 2009/10.

4.1.4 Rescheduling

The Council has engaged Sector Treasury Services to provide specialist advice with regard to Treasury Management activities. One of the areas where the expertise of external Treasury Consultants is of particular benefit is the identification of rescheduling opportunities – the premature repayment/replacement of existing loans to achieve revenue savings and/or the reduction of the Council's average rate of borrowing.

In 2009/10, there were few occasions when opportunities arose to reschedule PWLB loans. However, an opportunity arose in February 2010 and PWLB loans totalling some £21.45m were prematurely repaid (no replacement loans were taken for the reasons mentioned in para. 4.4).

The ongoing saving and discount achieved (Members are reminded that the discount must be applied to the Revenue Account over a period of 10 years) as detailed in appendix 1, is offset by the reduction in interest achievable on deposits (due to the reduction in balances available). The resultant net saving needs to be apportioned between the Council Fund and the HRA. The net saving to the Council Fund for 2010/11 compared to budget is estimated to be in the region of £500k.

4.1.5 Investments

The Annual Strategy for 2009/10 set out that:-

- the in-house team would manage all short-term investments in accordance with the Treasury Policy
- short-term investments should achieve, or better, a target rate of **1.00%**

In view of the uncertainty in the markets, it was recommended that investments (both new and maturing) be placed only with the Debt Management Account Deposit Facility (the U.K. government) and other local authorities.

4.1.6 Short-term Investments – up to 364 Days

Throughout the year the in-house team managed investments averaging £79.98m. The return on these investments, which ranged from short-fixed to 364 days, was 0.67% compared with the target of 1.00%. The poor return was due to the fact that deposits were made only with the institutions mentioned in 4.6 – the rates of interest received from the DMADF averaging 0.29% over the year. The amount of interest earned on these investments (excluding interest due but not received from Icelandic banks) was some £617k compared with the original estimate of £569K. The increase in interest achieved, considering the reduction in the rate of interest achieved, is due to the timing of payments relating to job evaluation resulting in higher balances being available throughout the year and some £34k received in relation to Heritable Bank.

4.1.7 Long-term Investments

During December 2009, the final £10m of these investments matured. The decision was taken not to reinvest in long-term investments due to the uncertainty in the financial markets and therefore the sum was utilised for cashflow purposes, which helped in the repayment of £21.45m of debt (see para 4.1.4).

4.1.8 Icelandic Banks

The authority had deposits in Heritable and Landsbanki totalling £15m at the time of the collapse of the Icelandic Banks. These sums are subject to the ongoing administration and recovery procedures. Based on the information available in September 2009, the authority considered that an impairment (the difference between the amount outstanding and the amount likely to be recovered) should be recognised in the 2008/09 accounts.

In 2009/10, amounts were received from the administrators of Heritable to the value of £3.532m (including £34k in respect of interest) representing 34.98% of the amount outstanding, including accrued interest as at the 6/10/2008.

As anticipated no sums have been received in respect of Landsbanki to date. The administrative process under Icelandic legislation is taking considerably longer than the process for Heritable Bank, which is being dealt with under UK administrative law.

4.1.9 A table summarising the full Treasury Management portfolio of loans and investments is shown in ***Appendix 1.***

4.2 Prudential Indicators

4.2.1 Capital Financing Requirement

The capital financing requirement measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the authority does not associate borrowing with particular items or types of expenditure. In practice, the raising and repaying of loans is determined primarily by professional / expert advice, and may not necessarily take place in the relevant year. In order to create an operating environment within which the Treasury Manager can legitimately react to appropriate advice, the various authorised limits as identified in ***Appendix 2*** are set at a level in excess of the capital financing requirement.

During the year, the authority operated within the approved limits.

Appendix 4 shows the value of the Capital Financing Requirement as at 31 March 2010, based on the unaudited Balance Sheet position, is calculated to be £315.295m.

4.2.2 Prudential Indicators – "Prudence"

The Prudential Indicators for Treasury Management have, in the main, remained unchanged from those detailed in the Annual Strategy 2009/10 report presented to Council in February 2009. The only material change is the impact of PFI assets coming 'on balance sheet' as reported to Council in February 2010. Prudential indicators are shown in ***Appendix 2***. The authority is currently operating within approved limits.

4.2.3 Prudential Indicators – "Affordability"

There is a requirement to analyse and report the capital financing costs, and express those costs as a percentage of the net revenue streams of the authority. These are identified ***Appendix 3*** attached.

Financing costs to net revenue stream
General Fund - the unaudited out-turn, shows a marginal increase on the previously forecast position. This is mainly attributable to revenue contributions to capital.

HRA
The ratio is marginally lower mainly as a result of a higher net revenue stream offsetting the impact of revenue contributions to capital.

Incremental effect of capital investment
Both General Fund and HRA, show a marginal reduction in this measure as a result of the reduction in interest costs.

4.2.4 Capital Expenditure and Funding

Capital Expenditure is reported in ***Appendix 4***, for information purposes. The table indicates the unaudited position as at 31 March 2010 compared to the previously reported forecast. More detail will be reported in due course.

5. FINANCIAL IMPLICATIONS

5.1 This report deals with financial matters.

6. PERSONNEL IMPLICATIONS

6.1 There are no personnel implications.

7. RECOMMENDATIONS

7.1 Members are asked to note the report.

8. REASONS FOR THE RECOMMENDATIONS

8.1 Compliance with the CIPFA “Code of Practice for Treasury Management in the Public Services”.

9. STATUTORY POWER

9.1 Not applicable.

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Background Papers:
Treasury Management Working Papers – Accountancy Section
CIPFA “Code of Practice for Treasury Management in the Public Services”
The Local Government Act 2003
Local Authorities (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2004