Treasury Management – Outturn Report 2008/09

1 THE ISSUE

1.1 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan for 2008/09

2 RECOMMENDATION

2.1 That the Cabinet accepts the treasury management report to 31st March 2009 prepared in accordance with the CIPFA Treasury Code of Practice and notes the performance.

3 FINANCIAL IMPLICATIONS

3.1 Included in the report.

4 TREASURY PERFORMANCE

4.1 Performance against the Treasury Management & Prudential Indicators agreed as part of the annual Treasury Management Strategy is provided in Annex 1. The outturn position is within all the limits agreed in February 2008 as shown in Annex 1.

Summary of Returns 2008/09

4.2 The Council's investment position as at 31st March 2009 and performance in 2008/09 is given in Annexes 2 and 3. In line with the Annual Investment Strategy, investments undertaken were temporary short term investments made with reference to the core balance and cash flow requirements.

4.3 Gross interest earned from investments for 2008/09 totalled £4.733m. Net interest received, after deduction of amounts due to the Avon Pension Fund, West of England Growth Points, PCT, schools and other internal balances, is £2.911m. The average rate of interest earned on investments over this period was 4.55%, which is 0.81% above the benchmark rate of average 7 day LIBID + 0.05% (3.74%). This represents an extra £518k of interest income earned above the benchmark rate.

Summary of Borrowings 2008/09

4.4 The Council's external borrowing as at 31st March 2009 is detailed in Annex 4. No further borrowing was taken during the year. Following concerns regarding elevated levels of credit risk, falling short term investment rates and in light of the Council's cash balances, the decision was taken to use internal resources rather than external borrowing to finance capital spending during the year. This has the effect of reducing the council's investment balance and so the amounts it lends on the money markets to financial institutions.

Strategic & Tactical Decisions

4.5 As detailed in the 2008/09 annual economic review attached at Annex 6, provided by Sterling, the Council's Treasury Advisors, the markets remain high risk and we have therefore continued to adopt a cautious strategy in this environment. We have continued to place a significant proportion of our funds with the UK Government Debt Management Office and otherwise with highly-rated major financial institutions, primarily with UK banks, where we assess there is implicit or explicit Government support.

4.6 Over the past year the Council has taken a pro-active risk management approach to its investment decisions due to the volatility of the financial markets and banking sector. This approach included the following actions:

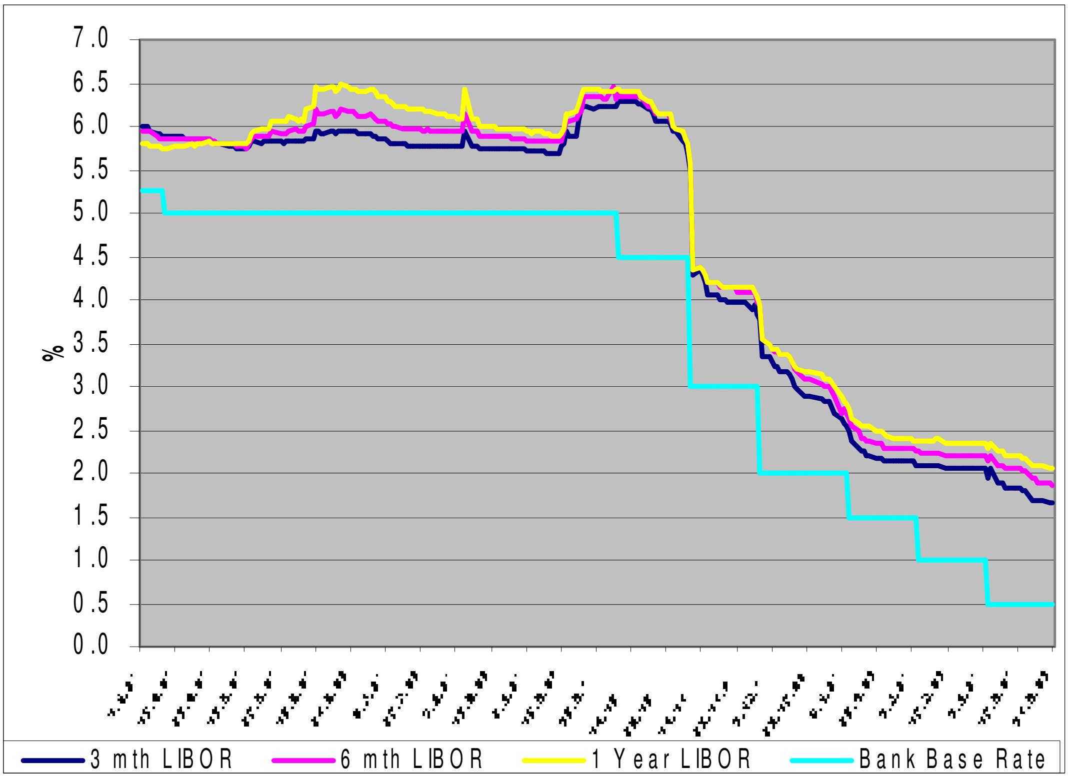
(1) March 2008 – All new fixed term investments were placed with the UK Governments Debt Management Office (AAA rated);

(2) May 2008 – reinstated fixed term lending to banks on the approved lending list that had a long term rating of at least AA- (but placing funds with the highest rated counterparties available) with investments limited to 3 months;

(3) October 2008 – A report was taken to Group Leaders explaining the current investment policy and approval was given to increase the counterparty limits from £10m to £20m for UK banks with high credit ratings, on the basis that they either had already or were likely to receive support from the UK Government should they experience financial difficulties. The temporary three month investment period limit was removed for these banks to enable some mitigation against projected falls in the base rate. This was reported formally to the Council on 20th November 2008.

4.7 The following graph shows how the interbank interest rates have moved during the year in relation to the UK bank rate.

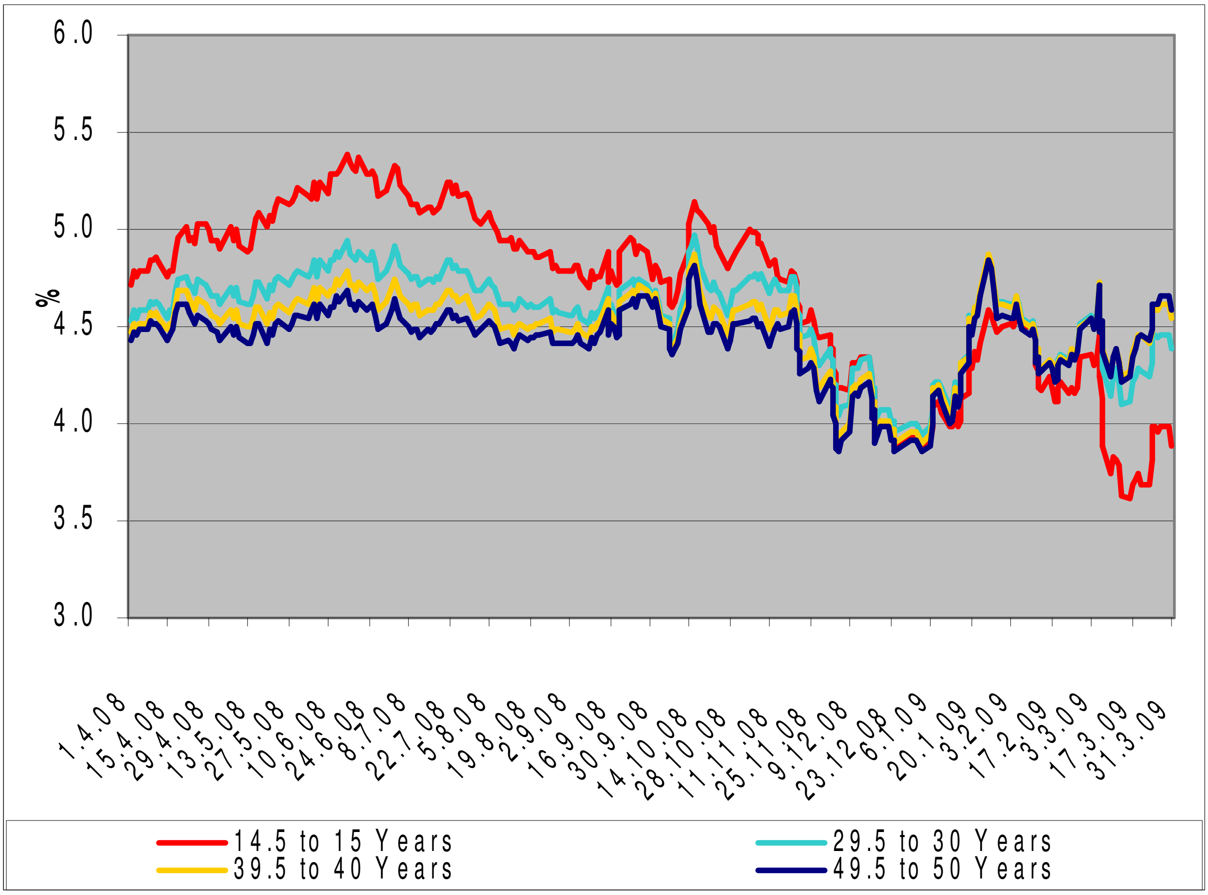
2008/09 Interest rates: 3, 6 & 12 month LIBOR versus UK Bank Rate



4.8 The graph highlights the rapid series of reductions in bank rate by the Bank of England as it switched its focus from managing inflation concerns to addressing the deepening recession. Short term market rates have continued to track at a premium to bank rate as liquidity in the interbank market remained strained due to the credit crunch and a lack of confidence curtailing lending between banks.

4.9 The following graph shows the movement in PWLB (Public Works Loan Board) rates for borrowing in a sample of maturity periods during the financial year.

<u>PWLB rates 2008/09</u>



4.10 The graph shows that rates for longer periods have generally remained at around 4.5%, although they dip to around 4% as investors switched from equities into gilts as a safe haven as recession fears increased. Towards the end of the financial year short term rates reduced linked to the falling Bank of England bank rate.

Treasury Management Advice Contract

4.11 Following a market test exercise relating to the consultancy advice the Council receives in respect of Treasury Management, the Council has awarded this contract to Sterling Consultancy Services for a three year period (with a possible extension to five years). The contract commenced on 1st October 2008 with a reduction in the annual fee of £7k.

Budget Implications

4.12 An amount of £7.042m was included in the Councils 2008/09 revenue budget for capital financing costs. A number of budget transfers have taken place during the year reflecting the favourable investment income position, resulting in a final year end budget for capital financing of £6.167m.

4.13 A breakdown of this budget and the actual year end position is included in Annex 5. This shows an underspend at outturn of £2.283m in 2008/09. The underspend is due to the following factors:

- Minimum Revenue Provision (MRP) in respect of debt repayments underspend of £528k due to the final capital spend in 2007/08 being underspent compared to the estimate used in setting the 2008/09 budget for MRP.

- Additional interest earned from the higher ongoing cash balances from 2007/08 totalled £1.571m, which also resulted in a reduction in the requirement to borrow, negating the associated borrowing costs. This is a result of ongoing slippage in the Capital Programme plus a £4.75m VAT refund on museum admissions.

5 RISK MANAGEMENT

5.1 The Council's lending & borrowing list has been regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment & Borrowing advice is provided by our Treasury Management consultants Sterling.

6 RATIONALE

6.1 The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

APPENDIX 12 - ANNEX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2008/09 Prudential Indicator	**2008/09 Actual as at 31st Mar 2009**
	£'000	£'000
Borrowing	105,000	80,000
Other long term liabilities	2,000	0
Cumulative Total	**107,000**	**80,000**

2. Operational limit for external debt
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2008/09 Prudential Indicator	**2008/09 Actual as at 31st Mar 2009**
	£'000	£'000
Borrowing	100,000	80,000
Other long term liabilities	2,000	0
Cumulative Total	**102,000**	**80,000**

3. Upper limit for fixed interest rate exposure
This is the maximum % of total borrowing which can be at fixed interest rate.

	2008/09 Prudential Indicator	**2008/09 Actual as at 31st Mar 2009**
	%	%
Fixed interest rate exposure	**100**	**75.0***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the rate increase)

4. Upper limit for variable interest rate exposure
While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping a degree of flexibility through the use of variable interest rates. This is the maximum % of total borrowing which can be at variable interest rates.

	2008/09 Prudential Indicator	**2008/09 Actual as at 31st Mar 2009**
	%	%
Variable interest rate exposure	**50**	**25**

5. Upper limit for total principal sums invested for over 364 days

Due to the uncertainty in the market and difficulties currently surrounding accurate Capital cashflow, we have decided not to invest for a period greater than 364 days.

This is the maximum % of total investments which can be over 364 days.

	2008/09 Prudential Indicator	**2008/09 Actual as at 31st Mar 2009**
	%	%
Investments over 364 days	**80**	**0**

6. Maturity Structure of new fixed rate borrowing during 2008/09

	Upper Limit	**Lower Limit**	**2008/09 Actual as at 31st Mar 2009**
	%	%	%
Under 12 months	50	Nil	0
12 months and within 24 months	50	Nil	0
24 months and within 5 years	50	Nil	0
5 years and within 10 years	50	Nil	0
10 years and above	100	Nil	0

No new borrowing taken in 2008/09

7. Capital Financing as % of Net Revenue Stream

	2008/09 Prudential Indicator	**2008/09 Provisional as at 31st Mar 2009**
	%	%
Capital Financing as % of Net Revenue Stream	**6.48**	**3.31***

Note: Capital financing includes the amount paid to Bristol City Council in respect of Ex-Avon Debt and Net Revenue Stream is net of Dedicated Schools Grant (DSG).
The lower projection reflects the under spend on capital financing compared to budget referred to in the main report.
* Part of the reduction in the percentage is due to an increase in the overall net revenue budget of the Council following a technical change relating to Area Based Grants (£7.2m).

APPENDIX 12 - ANNEX 2

The Council's Investment position at 31st March 2009

	Balance at 31st March 2009
	£'000's
Notice (instant access funds)	13,900
Up to 1 month	22,500
1 month to 3 months	20,000
Over 3 months	25,000
Total	**81,400**

The investment figure of £81.4 million is made up as follows :

	£'000's
B&NES Council	32,026
West of England Growth Points	7,802
Schools	12,205
Pension Fund	29,367
Total	**81,400**

The Council had an average net positive balance of £69.9m (including Growth Points Funding) during the period April 2008 to March 2009.

The following fixed term investments were undertaken during 2008/09 with a maturity date in the following financial year:

Institution	Amount	Rate	Start Date	Maturity Date
Barclays Bank	£5m	5.20%	03/11/08	28/08/09
Barclays Bank	£5m	5.20%	03/11/08	28/09/09
Barclays Bank	£5m	3.20%	03/12/08	02/12/09
Bank of Scotland	£5m	6.41%	31/10/08	28/10/09
Bank of Scotland	£5m	3.03%	09/01/09	08/01/10
Bank of Scotland	£5m	2.98%	13/01/09	12/01/10
Nationwide Building Society	£5m	5.90%	22/10/08	22/04/09
Nationwide Building Society	£5m	5.60%	04/11/08	28/04/09
HSBC	£5m	1.27%	04/02/09	05/05/09*
HSBC	£5m	1.27%	05/02/09	05/05/09*
HSBC	£5m	2.65%	03/12/08	02/12/09
Debt Management Office	£3.5m	0.35%	16/03/09	17/04/09
Debt Management Office	£7m	0.35%	16/03/09	23/04/09
Debt Management Office	£2m	0.35%	31/03/09	16/04/09
Total	**£67.5m**	-	-	-

* Two of the HSBC investments are a six month fixed term deposit with an option for the bank to call the deposit in 3 months – therefore the maturity date given above is the date of the bank's call option.

APPENDIX 12 ANNEX 3

Average rate of return for 2008/09

	Apr %	**May %**	**Jun %**	**Jul %**	**Aug %**	**Sep %**
Average rate of interest earned	5.18%	5.07%	5.23%	5.34%	5.38%	5.39%
Benchmark = Average 7 Day LIBID rate +0.05% **(source: Sector)**	5.12%	5.04%	5.06%	5.03%	5.01%	5.27%
Performance against Benchmark %	+0.06%	+0.03%	+0.17%	+0.31%	+0.37%	+0.12%

	Oct %	Nov %	Dec %	Jan %	Feb %	Mar %	Average for period %
Average rate of interest earned	5.11%	4.81%	3.88%	3.26%	2.86%	2.90%	4.55%
Benchmark = Average 7 Day LIBID rate +0.05% **(source: Sterling)**	5.28%	3.40%	2.10%	1.61%	1.16%	0.68%	3.74%
Performance against Benchmark %	-0.17%	+1.41%	+1.78%	+1.65%	+1.70%	+2.22%	0.81%

APPENDIX 12 ANNEX 4

Councils External Borrowing at 31st March 2009

LONG TERM	**Amount**	**Fixed Term**	**Interest Rate**	**Variable Term**	**Interest Rate**
PWLB	10,000,000	30 yrs	4.75%	n/a	n/a
PWLB	20,000,000	48 yrs	4.10%	n/a	n/a
PWLB	10,000,000	46 yrs	4.25%	n/a	n/a
PWLB	10,000,000	50 yrs	3.85%	n/a	n/a
PWLB	10,000,000	47 yrs	4.25%	n/a	n/a
KBC Bank N.V*	5,000,000	2 yrs	3.15%	48 yrs	4.5%
KBC Bank N.V*	5,000,000	3 yrs	3.72%	47 yrs	4.5%
Eurohypo Bank*	10,000,000	3 yrs	3.49%	47yrs	4.5%
TOTAL	**80,000,000**				
TEMPORARY	**NIL**				
TOTAL	**80,000,000**				

- All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.5%. The lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower also has the option to repay the loan without penalty.

APPENDIX 12 ANNEX 5

Capital Financing Costs – Budget Monitoring 2008/09 (Outturn)

April 2008 to March 2009	YEAR END POSITION Budgeted Spend or (Income) £'000	Actual Spend or (Income) £'000	Actual over or (under) spend £'000	ADV/FAV
Interest & Capital Financing				
- Debt Costs	3,354	3,271	(83)	FAV
- Ex Avon Debt Costs	1,840	1,739	(101)	FAV
- Minimum Revenue Provision (MRP)	2,313	1,785	(528)	FAV
- Interest on Balances	(1,340)	(2,911)	(1,571)	FAV
Sub Total - Capital Financing	**6,167**	**3,884**	**(2,283)**	**FAV**

APPENDIX 12 ANNEX 6

Annual Review 2008/09 – (provided by Sterling Treasury Advisors)

- Inflation was the major concern at the start of the year as oil, food and commodity prices rose sharply. Oil prices eventually peaked in July at a record $147 per barrel, pushing up retail energy and petrol prices.
- The Governor of the Bank of England, Mervyn King, wrote a series of letters to the Chancellor explaining why the CPI measure of inflation was more than 1% over the 2% target. CPI eventually peaked at 5.2% in September.
- Rising inflation meant that the Monetary Policy Committee (MPC) was reluctant to reduce interest rates to provide a buffer against the expected credit crunch induced recession.
- Throughout the year banks and building societies continued to struggle to source funding due to higher perceived levels of credit risk. This was largely due to uncertainty and mistrust. Institutions were more inclined to hoard cash than lend to other institutions, which might be exposed to losses on sub-prime mortgages or other forms of toxic debt.
- The Bank of England pumped short-term cash into the money markets and eased liquidity problems, but as the economy weakened, attention turned to capital levels. Banks that were over-exposed to higher risk loans and toxic debt lost the confidence of investors and lenders.
- In the tougher market conditions and the slowing economy, financial institutions aggressively de-leveraged, restricting lending to companies and households. This exacerbated the slump in both domestic and global trade and economic activity.
- On 15th September, the situation perceptibly worsened when the US Treasury allowed Lehman Brothers to file for bankruptcy. Confidence in the worldwide banking system plummeted, further increasing the pressure on other financial institutions.
- Shortly afterwards, the UK government encouraged a merger between Lloyds TSB and HBOS. At the same time banks in Europe, including Dexia, Fortis and Hypo Real Estate had to be rescued by their respective governments to avoid outright failure. The Icelandic banks also experienced problems, but were too big to be rescued by the Icelandic government. The banks were put into receivership in an effort to protect them from creditors.

- In early October the UK government was effectively forced to step in and support the Royal Bank of Scotland and Lloyds TSB/HBOS by taking a stake in each bank. The move helped to steady the nerves in financial markets. The government also announced various plans to stimulate the UK economy, most notably a year-long VAT cut.
- Other world governments followed suit, implementing both bank rescue measures and fiscal stimulus plans. By the turn of the year confidence in financial markets began to grow that governments would not allow banks to fail.
- However, the problems in the banking sector, on-going restricted lending and the slump in the housing market caused sharp falls in both company and household confidence. Spending fell in response, the fall exacerbated by rising unemployment. The UK economy contracted 1.9% in quarter four of 2008/09, following a 1.6% decline in quarter three.
- The sharp economic contraction along with significant falls in commodity prices raised the spectre of deflation. In order to avoid this outcome and meet its 2% CPI target, the Bank of England reduced Bank Rate to 0.5% and implemented a policy of quantitative easing in the second half of the year.
- The true impact of these actions has yet to be seen, but the Bank will be hoping that the significant amount of economic stimulus from various sources is enough to enable the UK economy to recover from recession.