COUNCIL

Annual Treasury Management Report 2008/09
16 September 2009

Report of Cabinet

PURPOSE OF REPORT
This report sets out the performance of the Council in respect of Treasury Management for 2008/09 and seeks Council's approval for various Prudential Indicators following on from last year's outturn position.
This report is public.

RECOMMENDATIONS

That the report be noted and that the Prudential Indicators as set out at Appendix B be approved.

1 **Introduction**

1.1 At the Cabinet meeting held on 28 July 2009, Members considered an annual report on the performance of the treasury function, which covers borrowing and investment activities. Cabinet also considered various associated Prudential Indicators tied in with the provisional revenue and capital outturn for the year (minute 32 refers).

1.2 Under the Code of Practice on Treasury Management in Local Authorities, it is a requirement that an information report on these matters be presented to Council as well as Cabinet; furthermore the Prudential Indicators must be approved ultimately by Council. This report is in accordance with those requirements.

1.3 As all the information has already been included on the Cabinet agenda and therefore circulated to all Members, this report highlights only the main issues arising. The glossary of terms has been included at ***Appendix A,*** and a full schedule of Prudential Indicators is included at ***Appendix B.***

2 **Icelandic Investments**

The Council has £6M of investments at risk, tied up with the collapse of the Icelandic banking sector. To assist with the closure of the 2008/09 accounts, standard accounting guidance was issued to all local authorities, giving details of possible rates of return. This guidance is summarised overleaf:

Bank	Return	Timing of payment
KSF (£2M)	At least 50% of principal and interest accrued up to 7/10/08.	10% expected July 2009, further payments spread evenly up to October 2012.
Glitnir (£3M)	100% of principal and interest up to 14/11/08 for priority creditors.	All payable March 2010
Landsbanki (£1M)	Between 95% of principal and interest payable up to 14/11/08 for priority creditors.	Payable in instalments up to December 2012.

These have been used as the basis for the year end entries in the 2008/9 draft accounts. Using these figures, the Council has “impaired” its Icelandic assets by £1.6M (i.e. this is the total estimated loss in value). This, however, takes into account the interest accrued on these investments, as well as the timing of repayments. On a simple cash basis, using the above assumptions, the Council would expect to get back at least £4.95M of the £6M originally invested – i.e. an estimated principal loss of around £1M.

It is important to note though that definitive statements from the Administrators are still awaited. Furthermore, at the time of writing this report, more up to date accounting guidance regarding the estimation of such investment losses was expected, and this will need to be considered in finalising last years’ accounts. Any implications will be reported to Audit Committee on 23 September.

3 Borrowing

3.1 Longer Term Borrowing and Funding of Capital.

Long term borrowing is an important part of the Council’s capital financing. Under the Prudential Code a key indicator is the Capital Financing Requirement (CFR). Borrowing should not exceed the CFR on a long term basis, as this could indicate that loans are being used to fund expenditure other than capital. For 2008/09 the figures were as follows:

	£000
Opening CFR	45,595
Closing CFR	45,857
Average CFR	**45,726**
Weighted average borrowings	44,752
Weighted average investments	20,565
Net borrowings	**24,187**

From this it is clear that net borrowings are well below the Council’s CFR, and average gross borrowings are in line with it. This supports the reported position, i.e. that long term borrowing has not been used to fund revenue activities.

In addition, other indicators are set to control the absolute amount of debt (the Authorised limit) and expected gross debt but allowing for day to day cash management (Operational Boundary). The Council has operated well within the set boundaries. Below is the year end position:

	Actual Debt 31/3/2009	**Operational Boundary**	**Authorised Limit**
	£000's	**£000's**	**£000's**
Deferred Liabilities	223	-	310
PWLB Debt	39,215	-	) 56,290
Temporary borrowings	8,500	-	)
Total	47,938	49,100	56,600

The year end was also the point at which the Council was most indebted during 2008/09, due to the scheduled reduction of local tax income receipts in February and March (instalments are due over the period from April to January, and so income tails off in the last two months of the year).

3.2 Debt Maturity (or Repayment) Profile

One Prudential Indicator which is used to manage liquidity risk is the maturity structure of borrowing. This indicator introduces limits to help reduce the Council's exposure to large fixed rate sums falling due for repayment (and potentially re-financing) all at once. The table below shows these profiles at the beginning, middle and end of the year against the indicator.

The movement in profile is due to the repayment of £5.6M of PWLB debt in January 2009. This was done to save interest costs but this cash had to be replaced by temporary loans, at least for a time. These temporary loans will be repaid as fixed term investments mature, with the net position being an overall reduction in both debt and investment balances.

	Prudential Indicator	**Actual 31/3/08**	**Actual 31/9/08**	**Actual 31/3/09**
Under 12 months	0-35 %	0%	0%	18%
12 – 24 Months	0 - 5%	0%	0%	0%
24 – 5 years	0 – 10%	0%	0%	0%
5 – 10 years	0 – 20%	0%	0%	0%
10 years above	60 – 100%	100%	100%	82%

3.3 Interest Payable on Longer Term Borrowing

The average rate of interest payable on PWLB debt in 2008/09 was 5.56%, which was identical to 2007/08. However, the cost of long term borrowing showed a favourable variance against the revised budget:

	£'000
2008/09 Estimate	2,478
2008/09 Actual	2,436 (of which £837K was charged to the HRA)
Variance	42 (favourable)

The variance is due to the repayment of loans in January, saving 4.5% on £5.6M of loans for 2 months, with an ongoing annual saving estimated at £251K per annum.

All the interest payable was in relation to fixed interest loans. Prudential Indicators also provide exposure limits that identify the maximum limit for variable / fixed interest rate exposure, based upon the debt position. The table below shows that the outturn position was within the limits set by Members at the beginning of the year.

	Prudential Indicator	**Actual**
	%	**%**
Fixed Rate	100	100
Variable Rate	30	0

As yet there is no information available for last year with which to compare performance with other local authorities.

4 Shorter Term Borrowing (to support cash flow)

During 2008/09 some short term borrowing was required to support the Council's cash position toward the end of the year. As mentioned earlier, this need was influenced by the decision to repay PWLB loans early, and to cover £3M of Icelandic bank deposits that were due back in January. The interest cost of the loans (£5K) was more than offset by the savings on PWLB loans.

5 Investment Activities

5.1 Performance against Prudential Indicators

In 2008/009 all investments were placed in accordance with the approved Investment Strategy. There was one minor breach of investment limits in the year as reported in the Qtr 3 treasury monitoring report. This was as a result of a bank returning an investment to an old account by mistake; no loss resulted from this.

From the start of 2008/09, the Council had only 1 investment due to mature 365 days or more from any point in the year. This was the £1M investment with Landsbanki, which was taken out in May 2007 for a 2 year period. Although this was well within the approved Performance Indicator limit of £6M, ultimately the bank involved defaulted. For the last half of 2008/09, the Council shortened its investment periods significantly, in light of current economic conditions.

5.2 Performance against budget and external benchmarks.

Interest earned in the year can be summarised as follows:

Interest earned	£803K (£203K of which was credited to the HRA)
Revised budget	£1,003K.
Variance	£200K adverse

This figure is lower than that reported for the end of Quarter 4, as in effect all Icelandic bank interest has been stripped out. This is in line with the accounting guidance as mentioned in section 2.

In terms of performance against external benchmarks, our investment returns can be summarised as follows:

Base Rate	3.61%
3 Month LIBID	4.59%
Lancaster CC investments*	3.91%
Lancaster CC investment 0708	5.82%

*This rate includes £6M frozen in Icelandic banks, but assumes they are not generating any interest.

Overall, the investment returns were within the range limited by the base rate and LIBID (London Inter-bank Bid) rate. In comparison to the prior year, there is a marked drop in the returns, which reflects the changes in the global economic conditions. It is anticipated that the returns for 2009/10 will be lower still, as the full impact of investment rate reductions is felt.

Following the Icelandic banking crisis, the approach to investing changed markedly. No new fixed term investments were placed after 08 October 2008 and Officers chose to repay £5.6M of debt towards the end of the year, rather than invest cash. This reduced counterparty risk and saved interest charges. The Investment Strategy for 2009/10 approved in February formalised a much more conservative approach to managing surplus cash.

Similar to the borrowing comparators, there is currently no information available regarding other Local Authorities' investment performance during 2008/09.

6 Other Risk Management Issues

Many of the risks in relation to treasury management are managed through the setting and monitoring performance against the relevant Prudential Indicators, as discussed above. There is also liquidity risk associated with accessing cash when it is needed, on a day to day basis, but for a local authority this is not judged as significant.

At a higher level though, the main focus and perception of risk within treasury management has changed over the year. The position has changed from a relatively stable economy with investment returns that were higher than the cost of much of the Council's debt, to one where investment returns have slumped and the credit worthiness of counterparties is paramount. The Council's Investment Strategy is designed to engineer risk management into investment activity largely by reference to credit ratings and length of deposit, together with supporting advice. This strategy is required under the CIPFA Treasury Management Code, the adoption of which is another Prudential Indicator.

From the various national reviews undertaken so far, it is clear that there will be many changes to the treasury management framework in future, for all concerned – Officers, Members, Auditors, Consultants, and bodies such as CIPFA.

7 Other Prudential Indicators

As required under the Prudential Code, certain other year end Prudential Indicators must be calculated and reported. A full list of indicators is provided at ***Appendix B;*** those requiring specific Council approval are highlighted.

8 **Conclusion**

It is clear, given the Icelandic position, that the overall aim of treasury management policy, i.e. "to secure the most favourable overall position for the Council", has not been achieved in 2008/09. Work will continue to secure the best returns possible from Icelandic investments, and to help ensure that the policy aims can be achieved once again, in 2009/10 and beyond. This includes meeting any new requirements as may be implemented over the coming months.

RELATIONSHIP TO POLICY FRAMEWORK **This report is in accordance with the Council's Treasury Management Policy Statement.**	
CONCLUSION OF IMPACT ASSESSMENT **(including Diversity, Human Rights, Community Safety, Sustainability, etc)** **No direct implications.**	
FINANCIAL IMPLICATIONS **As set out in the report. These have also been incorporated into the outturn for 2008/09.**	
SECTION 151 OFFICER'S COMMENTS **The Section 151 Officer has been consulted and has no comments to add.**	
LEGAL IMPLICATIONS **Legal Services have been consulted and have no comments to add.**	
MONITORING OFFICER'S COMMENTS **The Monitoring Officer has been consulted and has no comments to add.**	
BACKGROUND PAPERS **Treasury Management Strategy and Policy documents 2008/09.**	**Contact Officer: Nadine Muschamp** **Telephone: 01524 582567** **E-mail: pnotley@lancaster.gov.uk**