CAB2042
FOR DECISION
WARD(S): GENERAL

CABINET

15 September 2010

PRINCIPAL SCRUTINY COMMITTEE

20 September 2010

TREASURY MANAGEMENT STEWARDSHIP REPORT FOR 2009/10

REPORT OF HEAD OF FINANCE

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RECENT REFERENCES:

CAB1785 : Treasury Management Strategy 2009-10, 4 February 2009
CAB1890 : Treasury Management Stewardship 2008-09, 16 September 2009
CAB1931 : Revised Investment Strategy 2009-10, 9 December 2009
CAB1960 : Treasury Management Strategy 2010-11, 3 February 2010
PS418: Treasury Management Informal Scrutiny Group, 12 July 2010

EXECUTIVE SUMMARY:

This report provides information on the stewardship of the Treasury Management function for the financial year 2009/10 and comments on treasury management activity during that financial year.

The Head of Finance confirms that no (external) borrowing was undertaken in 2009/10.

Appendix A provides the Actual Prudential Indicators.

The financial year 2009/10 continued the challenging environment of the previous year, although the second half of the year did see the UK economy recovering. The main implications of the exceptional circumstances have been deteriorating investment returns and continuing counterparty risk:

- £1,000,000 invested with Heritable Bank plc in Administration. At 31 March 2010 the Council had received £350,993 from the Administrator and received a further £62,961 in July 2010. The forecast is now for 85% recovery, which has increased from 80% lasting the previous year.

The counterparty policy as set out in CAB1785 in February 2009 was reviewed and made less restrictive by CAB1931 Revised Investment Strategy to avoid having 60%

of the Council's investments with the UK Government's Debt Management Office that was only paying 0.27% which equals 0.23% below base rate.

During the year, a review of the management processes and overview provided by Members with regard to the Council making large investments in undertaking treasury management was completed by a Treasury Management Informal Scrutiny Group. No significant matters were identified (see PS418 elsewhere on this agenda).

RECOMMENDATIONS:

To Cabinet:

That Cabinet approves the Treasury Management Stewardship Report for 2009/10 and the Actual 2009/10 Prudential Indicators at Appendix A.

To Principal Scrutiny Committee

That Principal Scrutiny Committee consider the Treasury Management Stewardship Report for 2009/10 and the Actual 2009/10 Prudential Indicators at Appendix A and determine whether to make any comments to the Portfolio Holder or (if of significance) to Cabinet.

CABINET

15 September 2010

PRINCIPAL SCRUTINY COMMITTEE

20 September 2010

TREASURY MANAGEMENT STEWARDSHIP REPORT FOR 2009/10

REPORT OF HEAD OF FINANCE

1 Introduction

1.1 The Council operates its treasury management service in compliance with the *Code of Practice for Treasury Management in the Public Services*, the *Prudential Code for Capital Finance in Local Government* (both published by CIPFA) , the *Guidance on Local Government Investments* and Minimum Revenue Provision Statement Statutory Guidance (both published by DCLG). The prime objective of the treasury management activity is the effective management and control of risk. The Guidance was revised and updated during 2009-10.

1.2 The Codes require the regular reporting of treasury management activities, forecasting likely activity for the forthcoming year (in the Annual Treasury Strategy Report – CAB1785) and reporting on actual activity for the preceding year (this report). Additionally for 2010-11 onwards a mid year review is also to be presented

1.3 This report covers:

- The capital activity for 2009/10
- The strategy agreed for 2009/10
- Performance indicators for 2009/10
- A summary of the economic factors affecting the strategy during 2009/10
- The Council's treasury position at the year end
- Borrowing
- Investments
- The compliance of the treasury service with internal and external requirements
- Treasury Management Advisors

PS418, elsewhere on this agenda, provides the findings of the Treasury Management Informal Scrutiny Group which was set up during the year to investigate the management processes and overview provided by Members, with regard to the Council making large investments in undertaking Treasury Management.

2 The Council's Capital Expenditure and Financing 2009/10

2.1 The Council undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.); or
- If insufficient financing is available, or a decision is taken not to apply resources, the expenditure will give rise to a borrowing need.

2.2 The Council has previously fully financed its capital expenditure; however in 2009-10 capital expenditure has not fully been funded creating a Capital Financing Requirement (CFR).

2.3 The actual capital expenditure forms one of the required prudential indicators (Appendix A). The table below also shows how this was financed

£000's	2008/09 Actual	2009/10 Estimate	2009/10 Actual
General Fund	2,976	9,600	8,068
HRA capital expenditure	3,594	4,600	3,001
Total capital expenditure	**6,570**	**14,200**	**11,069**
Resourced by:			
Capital receipts	2,520	6,700	3,460
Capital grants & contributions	575	1,100	1,180
Major repairs allowance	3,094	3,400	2,924
Major investment reserve	0	2,500	351
Earmarked reserves	381	500	552
Total Resources Applied	**6,570**	**14,200**	**8,467**
Capital Financing Requirement	**0**	**0**	**2,602**

2.4 The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position. It represents the 2009-10 capital expenditure which has not yet been paid for by revenue or other resources.

2.5 Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council. The Council's Capital Financing Requirement is currently funded using temporary cash resources from the Council's own working capital.

2.6 **Reducing the CFR** – Whilst under treasury management arrangements actual debt can be borrowed or repaid at any time within the confines of the annual Treasury Strategy, the Council is required to make an annual revenue charge to reduce the General Fund CFR. The CFR of £2,602k incurred in the year was all GF, HRA capital expenditure was fully funded by capital resources.

2.7 The statutory revenue charge is called the Minimum Revenue Provision (MRP). The total CFR can also be reduced by:

a) The application of additional capital resources, such as unapplied capital receipts, or

b) charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP)

2.8 The Council's MRP policy (as required by CLG Guidance) was included in CAB1785. There is no MRP in 2009-10.

3 Treasury Management Strategy for 2009/10

3.1 The Treasury Management Strategy for 2009/10 was approved by Council on 19 February 2009 (CAB1785 refers) but due to a return to more normal market conditions, whilst still remaining nervous following the exceptional instability on the world markets, a revised investment strategy was approved by the Council on 13 January 2010 (CAB1931 refers).

3.2 It should be noted that the accounting practice required to be followed by the Council (the SoRP) requires financial instruments in the statutory accounts (debt, investments, etc.) to be measured in a method compliant with national Financial Reporting Standards. The figures in this report are based on the principal amounts borrowed and invested and so may differ from those in the final accounts by items such as accrued interest.

4 Performance Indicators

4.1 The following treasury management indicators were set for 2009/10:

a) Debt – Borrowing - Average rate of borrowing for the year compared to average available.

b) Debt – Average rate movement year on year.

c) Investments – Internal returns above the Bank Base Rate.

d) Investments – External fund managers - returns 110% above 7 day compounded LIBID.

4.2 Performance against these indicators was as follows:-

a) Not applicable, no debt.

b) Not applicable, no debt.

c) Investments:

- 0.5% Bank base rate which remained unchanged during the year
- 1.0% was the rate achieved excluding Heritable Bank
- 0.5% in excess of the performance indicator
- An additional £146,000 benefit to the Council based on average balance invested of £29,335,000.

d) Not applicable as no investment was managed by external fund managers.

5 Economic Background for 2009/10

5.1 Financial markets entered calmer waters in the early stages of the 2009/10 financial year as the worst fears of global depression and bank meltdown subsided. Nevertheless, while economies showed tentative signs of stabilising, a return to a positive growth path was still considered to be a long way off. Indeed, UK GDP data for the first half of 2009 registered its sharpest fall for over 20 years.

5.2 It was not until the summer months that economic performances began to stage a welcome improvement. Fear of a collapse of another leading financial institution lessened markedly and this was reflected in the more 'normal' behaviour of money market rates. That said, banking sectors in most countries were far from trouble free; asset write downs persisted, minor US banks continued to fail and the troubles of a number of building societies continued to make the headlines.

5.3 The UK economy continued to post a mixed performance and it was far from clear how far down the road to recovery it had travelled. The low point of the business cycle was passed during the third quarter of the year but the return to positive growth proved stubborn; for the UK this would not materialise until the fourth quarter of 2009.

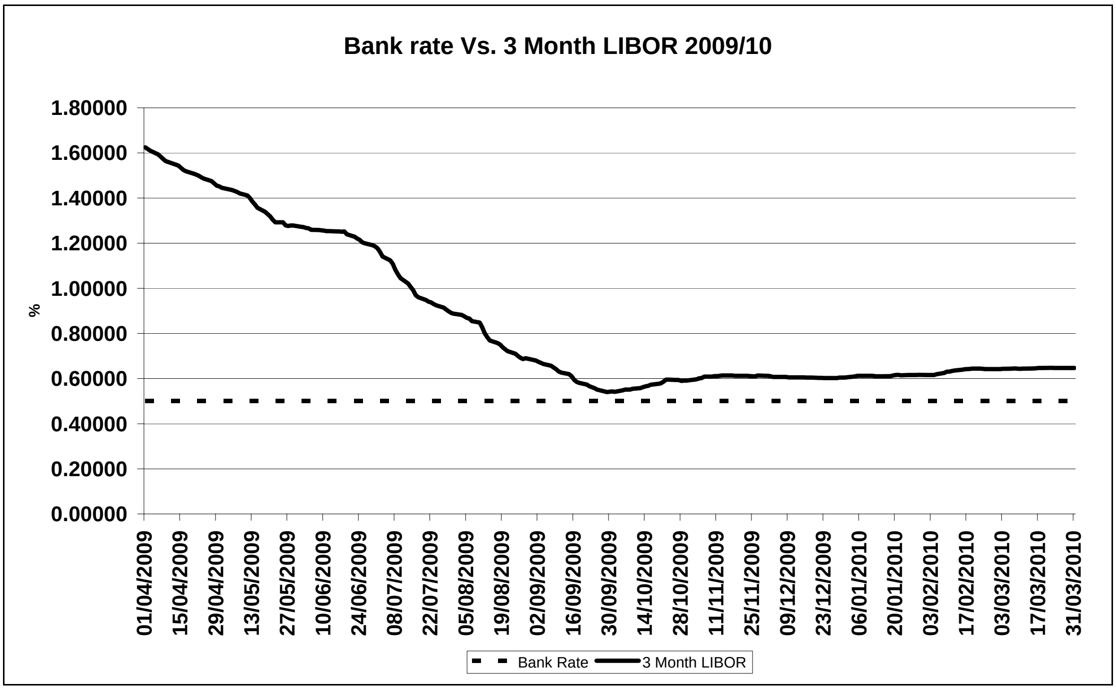
5.4 Industrial production was one of the buoyant areas of the economy, although it was far from consistent. The main area of uncertainty remained consumer spending. This key driver of economic activity was hampered by the household sector's striving to reduce its heavily indebted position. This, along with the continued deterioration in the employment situation and the weakness of earnings growth served as further deterrents to spending.

5.5 The bias of MPC decisions remained directed towards policy ease throughout the year. As official interest rates had been reduced to near-zero (0.5% Bank Rate) in March 2009, monetary relaxation took the form of the extension of the Quantitative Easing programme. The £125bn tranche sanctioned in March was followed by two further boosts, £50bn in August and £25bn in November 2009.

5.6 The accommodative policy approach, coupled with dwindling fears of financial collapse, created an environment in which money market rates eased to yet lower levels. In addition to this, the margin between LIBOR and LIBID rates returned to a more normal position. This was a sign that banks were more comfortable about transacting business between each other but the availability of credit to a wider cross-section of the economy remained problematic through to year-end.

5.7 Long-term interest rates did not suffer from the massive gilt funding requirement created by the surge in the public sector deficit. The Quantitative Easing (QE) programme was the principal source of market support. The large-scale purchasing of stock that this element of monetary policy required meant the Bank of England was to absorb virtually all of the year's supply.

5.8 Nevertheless, the programme was not sufficient to drive yields below the low point seen immediately after the inauguration of the QE programme in March 2009. Long-term rates remained generally erratic, (frequently registering large intra-day movements), but fluctuated within a comparatively narrow range. Investors were happy to take advantage of the support they were receiving from official activity but behaved in a manner that suggested most believed it is only a matter of time before the good fortunes of the market would come to an end. Indeed, yields returned to a rising trend once QE drew to a close in January 2010.



6 The Council's treasury position at the year end

Summary	31 March 2010		31 March 2009	
	Principal	Average Rate	Principal	Average Rate
Fixed Interest Rate Debt	0	0%	0	0%
Variable Interest Rate Debt	0	0%	0	0%
Total Debt	0	0%	0	0%
Short -term Fixed Interest Investments (excluding Heritable bank- see below)	£14.50m	0.57%	£20.80m	3.03%
Short-term Variable Rate Investments	£3.80m*	0.57%	£1.00m	0.51%
Long-term Variable Interest Investments	£1.00m	5.99%	£1.00m	6.40%
Total Investments (excl. Heritable)	£19.30m	0.85%	£22.80m	3.07%
Heritable Bank (in administration)	£0.65m	6.00%	£1.00m	6.00%

* includes Bank current account balance

7 Borrowing

7.1 Following the decision of Council on 27 February 2002 all long-term debt was prematurely repaid.

7.2 In the period 1st April 2009 to 31st March 2010 no loans were taken out but for short term operational reasons the agreed bank overdraft facility was used on 4 days, for a maximum of 2 days in a row.

8 Short Term Investments

8.1 Investment policy - The Council's investment policy is governed by CLG Guidance, which was updated 1 April 2010, has been implemented by the annual investment strategy approved by Council on 19 February 2009 (CAB1785 refers). Due to a return to more normal market conditions, whilst still remaining nervous, following the exceptional instability on the world markets, a revised investment strategy was approved by the Council on 13 January 2010 (CAB1931 refers). The investment activity during the year conformed to the approved strategy.

8.2 The Council maintained an average balance of £29.3 million of internally managed funds achieving a return of 1.0%. The comparable performance indicator is the average Bank rate, which was 0.5%.

8.3 During the year 211 short term investments were made for on average 39 days in the average sum of £1.4m as well has having 2 call accounts and the current account which generates a return. This represents a 5 fold increase in activity compared to the pre financial meltdown of 2007-08. The last remaining 9 Investments, made in the heady days of rates of 6% plus, matured during the year contributing £107k to the investment income. The investments that were held at 31 March 2010 are shown in Appendix B.

8.4 Heritable Bank is a UK registered bank under Scottish law. The company was placed in administration on 7 October 2008. A total repayment of £351k (34.98%) was received in 2009/10, and the revised impairment is based on the assumption that a further 50% will be received by the end of 2012/13, taking the total dividends expected to be paid to 84.98%

Therefore, in calculating the impairment the Council has made the following assumptions about the timing of recoveries:

Date	**Repayment**	**Date**	**Repayment**
June 2010	5%	September 2011	5%
September 2010	5%	December 2011	5%
December 2010	5%	March 2012	5%
March 2011	5%	June 2012	5%
June 2011	5%	September 2012	5%

9 Long Term Investments

9.1 The only long-term investment the Council holds is with the Local Authorities Mutual Investment Trust (LAMIT). A property investment of £1 million was made in March 1990, with the General Fund receiving the investment income.

9.2 As at 31 March 2010 the value of this investment has risen to £0.913 million (£0.821 million at 31 March 2009), but remains impaired (that is below cost price). The impairment of £0.087 million is deferred in accordance with legislation, statutory instrument 2009/321, as it is expected to be a temporary situation caused by the current financial crisis. Dividends of £59,896 were received in 2009/10 (5.99%).

9.3 The ability to defer the impairment under statutory instrument 2009/321 applied to accounting years 2008-09 & 2009-10 and is not expected to be extended. As at the 31 July 2010 the Council's holding has risen to £0.945m, an impairment of £0.055m. If by the end of 2010-11 the valuation has not risen above the £1.0m historic cost the deferment will have to be charged to the General Fund as interest payable and similar charges.

10 Regulatory Framework, Risk and Performance

10.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance;

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the DCLG has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 11 March 2010.

10.2 The Council has complied with all of the above relevant statutory and regulatory requirements which require the Council to identify and, where possible, quantify the levels of risk associated with treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

11 Treasury Management Advisors

11.1 During 2009/10 Butlers continued to act as the Council's treasury management advisors offering support and advice on treasury management activities, which was taken up on a number of occasions.

OTHER CONSIDERATIONS:

12 SUSTAINABLE COMMUNITY STRATEGY AND CORPORATE BUSINESS PLAN (RELEVANCE TO):

12.1 Treasury Management supports all tenets of the Sustainable Community Strategy as well as the core value of being efficient and offering value for money.

13 RESOURCE IMPLICATIONS:

13.1 Interest and investment income amounted to £370k in 2009-10 (£1,929k in 2008/09).

14 RISK MANAGEMENT ISSUES

14.1 These are considered within the report.

BACKGROUND DOCUMENTS:

Operational and financial records held in the Financial Services Division.

APPENDICES:

Appendix A - Actual Prudential Indicators for 2009/10

Appendix B - Investments held at 31 March 2010

TREASURY MANAGEMENT STEWARDSHIP REPORT

Capital program	2008/09 Actual £000's	2009/10 Estimate £000's	2009/10 Actual £000's
General Fund	2,976	9,600	8,068
HRA capital expenditure	3,594	4,600	3,001
Total capital expenditure	**6,570**	**14,200**	**11,069**
Resourced by:			
Capital receipts	2,520	6,700	3,460
Capital grants & contributions	575	1,100	1,180
Major repairs allowance	3,094	3,400	2,924
Major investment reserve	0	2,500	351
Earmarked reserves	381	500	552
Total Resources Applied	**6,570**	**14,200**	**8,467**
Unfinanced Capital Expenditure	**0**	**0**	**2,602**

General Fund, Affordability Prudential Indicator	2008/09 Actual £000's	2009/10 Actual £000's
Actual Capital Expenditure	2,976	8,068
Capital Financing Requirement	0	2,602
	%	%
Financing costs as a proportion of taxation and non specific grant income	0	0.1

Housing Revenue Account, Affordability Prudential indicator	2008/09 Actual £000's	2009/10 Actual £000's
Actual Capital Expenditure	3,594	3,001
Capital Financing Requirement	10,100	10,100
	%	%
Financing Costs as a proportion of Housing Rents	2.3	0.4

Total Capital Financing Requirement (CFR) £000's	31 March 2009 Actual	31 March 2010 Original Indicator	31 March 2010 Actual
Opening Balance	0	0	0
2009-10 un-financed capital	0	0	2,602
Less Minimum Revenue Payment	0	0	0
Less Voluntary Revenue Payment	0	0	0
Closing Balance	0	0	2,602

P. I. Net Borrowing should not exceed CFR except in the short term £000's	31 March 2009 Actual	31 March 2010 Original Indicator	31 March 2010 Actual
Net borrowing position	0	0	0
CFR	0	0	2,602

CAB2042
Appendix B

TREASURY MANAGEMENT STEWARDSHIP REPORT

Investments & Bank as at 31st March 2010

	31 March 2010			
Tier 1 UK Government	**£**	**Repayment Date**	**Rates %**	
Local Authorities: South Lakeland Council	1,000,000	01 April 2010	0.40	
Local Authorities: Bolton MBC	2,000,000	08 April 2010	0.40	
Local Authorities: Eastleigh Borough Council	1,000,000	20 April 2010	0.31	
Local Authorities: Redditch Borough Council	1,000,000	04 May 2010	0.30	
Local Authorities: The Highland Council	1,000,000	12 August 2010	0.55	
Local Authorities: Salford City Council	1,000,000	19 August 2010	0.55	
Local Authorities: Aberdeen Council	1,000,000	08 October 2010	0.55	
Local Authorities: South Cambridgeshire	2,000,000	15 December 2010	0.60	
Total Tier 1	**10,000,000**		**0.47**	
Tier 3 UK Banks eligible institutions of the 2008 Credit Guarantee Scheme				
National Westminster Bank Current Account	1,797,465	Current account	0.50	Variable
HBOS Bank of Scotland	1,000,000	Immediate Call account	0.50	Variable
Close Brothers	1,000,000	1 Day Call account	0.75	Variable
Co-operative Bank	500,000	29 April 2010	0.63	
Barclays	1,000,000	11 March 2011	1.80	
Total Tier 3	**5,297,465**		**0.80**	
Tier 4 A Rated UK Building Societies				
Coventry	1,000,000	16 April 2010	0.45	
Leeds	1,000,000	17 May 2010	0.52	
Nationwide	1,000,000	28 May 2010	0.45	
Total Tier 4	**3,000,000**		**0.47**	
All Short Term Funds	**18,297,465**		**0.57**	
Long Term Investments				
Local Authorities Mutual Investment Trust				
Principal	1,000,000	Flexible	5.99	Variable
Deferred Impairment	(87,067)			
Net Book Value	912,933			
Total Principal Bank & Investments	**19,297,465**		**0.85**	
Heritable Bank in Administration				
Principal	1,000,000	16 March 2009	6.00	
Impairment of Principal - 15%	(150,000)			
Received from Administrator	(350,993)			
Recoverable per LAAP82	499,007			
Note £62,961 distribution received from Administrator 16 July 2010				