Audit Committee – 24th June 2010

6. 2009/10 Treasury Management Activity Report

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Purpose of Report

1. To review the treasury management activity for the 2009/10 financial year as prescribed by the revised CIPFA Code of Practice and in accordance with the Council's Treasury Strategy and Annual Investment Policy and Treasury Management Practices.

Recommendations

2. Members are **RECOMMENDED** to: -

   (i) Note the Treasury Management Activity for the 2009/10 financial year;
   (ii) Note the outlook for the investment performance in 2010/11;
   (iii) Note the outturn position and explanation of variances for the Prudential Indicators for the 2009/10 financial year.
   (iv) Recommend the 2009/10 Treasury Management Activity Report to full Council

Background

3. A requirement of the Council's Treasury Management Code of Practice is the reporting to District Executive of the expected treasury activity for the forthcoming financial year, a mid year review outside of the budget setting process and subsequently the results of the Council's treasury management activities in that year. Treasury management in this context is defined as:

   > "The management of the local authority's cash flows, its borrowings and its investments, the management of the associated risks, and the pursuit of the optimum performance or return consistent with those risks".

4. Regular performance reports have been made throughout 2009/10 to the Portfolio Holder – Finance and Support Services.

5. The Prudential Code for Capital Finance in Local Authorities requires indicators to be set, some of which are limits, for a minimum of three forthcoming financial years. These indicators are included in this report.

The Strategy for 2009/10

6. Our treasury management strategy for 2009/10 was based upon minimising risk and safeguarding the capital sum. There was also a strategy of maintaining the stability of returns to enable the Council to have a balanced revenue budget.

7. The strategy also included the scope to invest in both Specified and Non-Specified investments, as defined by the Local Government Act 2003.

8. At the time of setting the Treasury Strategy Statement for 2009/10, the outlook for the economy and interest rates was as follows:

   - The UK, Eurozone and US economies were contracting, globally economies faced a prolonged recession or period of weakness following the financial market meltdown in the autumn of 2008.
   - Asset values were falling and were forecast to drop further, particularly those which related to commodities and housing.
   - The increase in food and energy inflation which had exerted a powerful squeeze on real incomes in 2008 was expected to fade in 2009
   - Wage inflation was forecast to remain low and labour market to remain weak; the threat of unemployment was likely to influence consumers to scale back spending and save instead.
   - The UK bank rate had been cut to 0.5% and in March 2010 and the Bank of England announced its initial £75bn of Quantitative Easing.

9. The budget for 2009/10 was set based on an annual interest rate of 3.75%, anticipating that any additional income in excess of budget would be transferred to balances or to finance capital expenditure.

Investment Outturn for 2009/10

10. The portfolio of investments at the start and end of the 2009/10 financial year was: -

	Value of Investments at 01.04.09 £	**Value of Investments at 31.03.10 £**	**Fixed/ Variable Rate**
Long Term Investments			
Euro Sterling Bonds	11,852,557	9,814,284	Fixed
Corporate Bonds	5,375,185	5,336,559	Fixed
Euro Sterling Bonds		2,000,630	Variable
Callable Deposits & Other Long Term Deposits	4,000,000	0	Fixed
Total	**21,227,742**	**17,151,473**	
Short Term Investments			
Short Term Deposits	14,000,000	19,000,000	Variable
Money Market Funds & Business Reserve Accounts	4,422,534	2,960,000	Variable
Total	**18,422,534**	**21,960,000**	
TOTAL INVESTMENTS	**39,650,276**	**39,111,473**	

11. The Council has £23.96m (61.3%) of its current portfolio of investments at variable rate of return and £15.15m (38.7%) at fixed rate of return. The strategic approach is to have 60% in variable rate investments and 40% in fixed investments. Whilst the portfolio currently closely reflects the strategic approach, varying economic

conditions will mean that the tactical and strategic approach are not always so closely aligned.

Investment Activity During Year

12. Interest rates began the financial year at 0.5% and have maintained this throughout 2009/10.

13. Two Eurosterling bonds with a nominal value totalling £3 million matured in December 2009. One Eurosterling bond was purchased in November 2009 with a nominal value of £1 million and a Eurosterling bond of £2 million was purchased in March. The overall holding in Eurosterling bonds is nominal value £11 million and Corporate bonds is nominal value £5 million.

14. Use has also been made of Business Reserve accounts (with Santander (through what was Abbey National) and Bank of Scotland), and Money Market Funds (Standard Life Investments, Invesco Aim, Blackrock Asset Management, Prime Rate Cash Management Fund and Henderson Liquid Assets Fund), all of which provide flexibility and liquidity in managing shorter-term cashflows. (Note Santander has at present been removed from our lending list because of the sovereign downgrading of Spain)

15. Further investments have been made with the Debt Management Agency Deposit Facility (DMADF), in order to secure the highest credit quality. The DMADF is a Government Lending and Borrowing facility, which benefits from a UK Government guarantee on investment, thus reducing credit and counterparty risk. This became increasingly important because of the volatility of the banking sector and at one point during the year SSDC had £6.5 million invested. However rates earned within the DMADF are very low compared to those on the open market.

16. On the advice of Arlingclose restricted investments are being made again in UK institutions covered by the UK Government 2008 Credit Guarantee Scheme and with long term ratings in the “AA” category. The institutions meeting this criteria were: Santander UK Plc, Barclays Bank, Clydesdale/Yorkshire Bank, HSBC Bank, Lloyds TSB Bank and Bank of Scotland (both part of the Lloyds Banking Group), Nationwide Building Society and Royal Bank of Scotland.

17. In 2009/10 the budget for treasury management income was £1,770k whereas the actual investment income earned was £2,208k, an additional £438k. This was principally due to a VAT reimbursement with an interest element of £563k and interest due on monies for the easement for the Birchfield site of £256k.

18. The table below compares the investment returns received for the 2009/10 financial year against the benchmark: -

see following page

	Actual Income £'000	% Rate of Return
Long Term Investments		
Euro Sterling Bonds	581	5.19%
Corporate Bonds	233	4.42%
Callable Deposits & Other Long Term Deposits	6	5.20%
Total	**820**	
Short Term Investments		
Short Term Deposits	507	1.99%
Money Market Funds & Business Reserve Accounts	40	0.62%
Total	**547**	
Other Interest		
Miscellaneous Loans	278	
Interest on VAT reimbursement	563	
Total	**841**	
TOTAL	**2,208**	**2.80%**
BUDGET INCOME	**1,770**	
INCOME IN EXCESS OF BUDGET	**438**	
BENCHMARK RATE OF RETURN (7-day LIBID)		**0.39%**

19. The budgeted rate of 3.75% wasn't achieved due to a fall in interest rates to 0.5% in March 09. Internal investments achieved an overall return of 2.8% however taking into account the investment in the Birchfield site this increased the return to 3.02%.

20. In line with the Treasury Management Strategy Statement and Annual Investment Strategy for 2009/10 the revised benchmark of the 7-day LIBID rate (which is the rate used for quick benchmarking by the CIPFA benchmarking club) will continue to be used.

Borrowing

21. An actual overall borrowing requirement (CFR) of £9.1 million was identified at the beginning of 2009/10. As interest rates on borrowing exceed those on investments the Council has used its capital receipts to fund capital expenditure. As at 31st March 2009 the Council had no external borrowing.

Treasury Management Reserve

22. The Treasury Management reserve has a balance of £500k. This was transferred to support the budget through any sustained reduction in interest rates in the 2009/10 financial year. There was no need to draw on it due to the interest received from the VAT reimbursement.

Outlook for 2010/11

23. In light of the interest rate being at an all time low of 0.5%, it is unlikely that the interest rate will fall any further. Predictions show that interest rates will remain stable for most of the coming financial year, with maybe a possible small increase at the end of 2010/11.

24. In the present financial climate the question of security is of greater importance than the rate of return. The well-publicised problems in the banking sector have caused a large number of financial institutions to have their credit ratings downgraded

25. The Council's investment policy is to lend to banks and building societies which are eligible institutions under the UK Government's 2008 credit guarantee scheme and that are at least A+ rating long term (or equivalent). As at 31st March 2010 the table attached (Appendix A) shows the distribution of investments placed, the duration, interest rate, credit ratings and a risk assessment of each investment scored by Arlingclose.

26. The Council's investment priorities are:

    - the security of capital (minimising the risk to its capital sum)
    - the liquidity of its investments (how quickly SSDC can realise its funds)
    - an optimum yield which is commensurate with security and liquidity.

27. This will inevitably reduce the investment income from what might be achieved with a less risk-averse strategy but is considered the most prudent course of action in what are likely to become increasingly difficult economic circumstances.

Balanced Budget

28. The Council complied with the Balanced Budget requirements.

Other Items

29. In November 2009 CIPFA released the revised Code of Practice for Treasury Management in the Public Services and accompanying Guidance Notes and the revised Prudential Code for Capital finance in Local Authorities. The Department for Communities and Local Government also issued revised Guidance on Local Authority Investments for English authorities. The revised Codes/Guidance re-emphasise an appropriate approach to risk management, particularly in relation to the security and liquidity of invested funds. Authorities were also required to demonstrate value for money when borrowing in advance of need and ensure the security of such funds. Authorities are now also required to have a separate body or committee responsible for the scrutiny of the treasury function. At SSDC this function has been allocated to the Audit Committee.

30. The Council has revised its treasury policy and practices documentation to take account of the requirements and changes in the revised codes and guidance.

Prudential Indicators 2009/10

31. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's Treasury Policy Statement and Annual

Treasury Strategy Statement. The outturn position for all Prudential Indicators including those set for capital are shown below:

Prudential Indicator 1 - Capital Expenditure

32. The actual capital expenditure incurred for the current year compared to budget is:

Capital Scheme Status	2008/09 £'000 Actual	2009/10 £'000 Revised	2009/10 £'000 Outturn	Variance £'000	Reason for Variance
Approved schemes	8,011	11,107	6,259	(4,848)	Decrease arises from the reprofiling of estimated spend from 2009/10 to future years
Investments	5,000	0	0	0	No Capital investments were made in 2009/10
Total Exp.	**13,011**	**11,107**	**6,259**	**(4,848)**	**See explanations above**

The figures in brackets reflect that actual expenditure was less than budgeted.

Prudential Indicator 2 - Ratio of Financing Costs to Net Revenue Stream

33. A comparison also needs to be made of financing capital costs compared to the revenue income stream to support these costs. This shows how much of the revenue budget is committed to servicing of finance. As SSDC's investments greatly outweigh our borrowing our financing costs are negative.

Portfolio	2008/09 £'000 Actual	2009/10 £'000 Revised	2009/10 £'000 Outturn	Variance £'000	Reason for variance
Financing costs	(2,982)	(1,865)	(2,159)	(294)	Interest rates were considerably lower than that budgeted however this was offset against a VAT interest reimbursement of £563k
Net Revenue Stream	19,735	19,885	19,765	(120)	The budget has been reduced by a VAT reimbursement of £631k. (The reimbursement was made up of two elements, VAT reclaimed and interest. The interest is shown in the box above). This was reduced by the approval of budget carry forwards £288k and increasing the voluntary redundancy reserve by £300k as well as various other smaller movements to and from reserves
%	15.1	9.3	11.2	(1.9)	See explanations above.

The figures in brackets reflect that investment income outweighs the cost of borrowing at SSDC.

34. The financing costs include interest payable, notional amounts set aside to repay debt and revenue contributions to capital less interest on investment income. The negative figure shows the extent that the Council is dependent on investment income.

Prudential Indicator 3 - Capital Financing Requirement

35. The capital financing requirement (CFR) measures the authority's underlying need to borrow for capital. The year-end capital financing requirement for the Council is shown below. The fact that there is no change between the opening and closing capital financing requirement means that SSDC has financed the in-year capital expenditure by methods other than borrowing;

	2008/09 £'000 restated Actual	**2009/10 £'000 Revised**	**2009/10 £'000 Outturn**	**Variance £'000**	**Reason for Variance**
Opening CFR	9,229	9,193	9,193	0	
Capital expenditure	13,011	11,107	6,259	(4,848)	See explanations for indicator 1 above
Capital receipts	(10,509)	(7,064)	(4,270)	(2,794)	Decrease in SSDC's contribution to the Capital Programme
Grants/ contributions	(2,502)	(4,043)	(1,989)	(2,054)	Due to the reprofiling to future years of estimated spend the income from grants and contributions has also been reprofiled to future years
Minimum Revenue Provision (MRP)	(36)	(36)	(36)	0	
Closing CFR	9,193	9,157	9,157	0	See explanations above.

Prudential Indicator 4 - Net External Borrowing compared to the medium term Capital Financing Requirement

36. The Council is also required to ensure that any medium term borrowing is only used to finance capital and therefore it has to demonstrate that the net external borrowing does not, except in the short term, exceed the total of capital financing requirements over a three year period.

	2008/09 £'000 Actual	**2009/10 £'000 Revised**	**2009/10 £'000 Outturn**	**Variance £'000**	**Reason for Variance**
Net Borrowing	(38,686)	(43,500)	(38,198)	5,302	Less investments at 31st March 2010 than estimated at the time of budget setting
CFR	9,193	9,157	9,157	0	

The figures in brackets reflect that SSDC has more investments than borrowings.

37. The figures show above indicate that we have a negative net borrowing requirement because our investments exceed our borrowing, therefore our capital financing requirement is not forecast at any time to be in excess of the net borrowing requirement.

Prudential Indicator 5 - Percentage of Maximum Investments in Fixed and Variable Rates of Interest

38. The authority must set for three years upper limits to its exposure to the effects of changes in interest rates. As a safeguard, it must ensure that it can have up to 100% invested in variable rate investments to cover against market fluctuations. Overall the authority is aiming to keep within the following exposure to fixed rates as and when market conditions improve:

	2008/09 % Actual	2009/10 % Maximum Limit	2009/10 % Outturn	Variance %	Reason for Variance
Fixed	43.82	80	38.7	41.3	Within limit.
Variable	56.18	100	61.3	38.7	Within limit.

Prudential Indicator 6 - Principal Sums Invested for Longer than 364 days (Upper Limits)

39. SSDC must also set upper limits for any investments of longer than 364 days. The purpose of this indicator is to ensure SSDC, at any time, has sufficient liquidity to meet all of its financial commitments. The following table summarises the position:

Maturity	2008/09 £'000 Actual	2009/10 £'000 Maximum Limit	2009/10 £'000 Outturn	Variance £'000	Reason for Variance
Between 1-2 Years	4,037	25,000	8,604	(21,396)	Within Limit
Between 2-3 Years	7,954	20,000	3,296	(16,704)	Within Limit
Between 3-4 Years	4,948	10,000	2,001	(7,999)	Within Limit
Between 4-5 Years	0	10,000	1,160	(8,840)	Within Limit
Over 5 Years	0	5,000	0	(5,000)	Within Limit

40. The table above shows that the Council adopts a policy of safeguarding its investments by minimising investments that are redeemable more than five years ahead.

Prudential Indicator 7 - Actual External Debt

41. This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

42.

Actual External Debt as at 31/3/10	£'000
Borrowing	0
Other Long-term liabilities	44
Total	**44**

Prudential Indicator 8 - Authorised Limit for External Debt

42. This limit represents the maximum amount that SSDC may borrow at any point in time during the year. If this limit is exceeded the Council will have acted ultra vires. It also gives the Council the responsibility for limiting spend over and above the agreed capital programme. A ceiling of £12 million was set for each year to allow flexibility to support new capital projects over and above the identified borrowing requirement.

	2008/09 £'000 Actual	2009/10 £'000 Maximum Limit	2009/10 £'000 Outturn	Variance £'000	Reason for Variance
Borrowing	0	11,900	0	(11,900)	SSDC has no external borrowing
Other long term liabilities	80	100	44	(56)	This is due to the transfer in 2008/09 with leases being classed as finance as opposed to operational
Total	**80**	**12,000**	**44**	**(11,956)**	

Prudential Indicator 9 - Operational Boundary for External Debt

43. The operational boundary sets the limit for short term borrowing requirements for cash flow and has to be lower than the previous indicator, the authorised limit for external debt. A ceiling of £10 million for each of the next three years was set.

	2008/09 £'000 Actual	2009/10 £'000 Maximum Limit	2009/10 £'000 Outturn	Variance £'000	Reason for Variance
Borrowing	0	9,920	0	(9,920)	SSDC has no external borrowing
Other long term liabilities	80	80	44	(36)	This is due to the transfer in 2008/09 with leases being classed as finance as opposed to operational
Total	**80**	**10,000**	**44**	**(9,956)**	

Prudential Indicator 10 - Maturity Structure of fixed rate borrowing during 2009/10

44. There is no requirement to report this indicator if SSDC is debt free.

Prudential indicator 11 - Band D Council Tax

45. SSDC must show the effect of its annual capital decisions for new capital schemes on the council taxpayer. Capital spend at SSDC is financed from additional receipts so the figures below actually show the possible decreases in council tax if all capital receipts were invested rather than used for capital expenditure.

	2008/09 Actual	2009/10 Budget	2009/10 Actual	2009/10 Variance
Decrease in council tax D band	£0.99	£0.92	£0.35	£0.57

46. The additional capital expenditure is higher than the budget due to additional schemes agreed outside the annual bid process. There are revenue implications of capital bids, which are not included in the ratio above. For example rent, salaries etc. A provision for this is made annually within the medium term financial plan and revised annually.

Conclusion

47. The Council has completed its sixth year of monitoring the indicators. The Council is within all limits set.

Background Papers: *Treasury Management Strategy and Annual Investment Policy for 2009/10, Monitoring Reports 2009/10*