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CABINET – 3 NOVEMBER 2010 **PORTFOLIO: FINANCE AND EFFICIENCY**

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE AND ACTUAL PRUDENTIAL INDICATORS 2009/10

1. INTRODUCTION

1.1 The annual treasury report is a requirement of the Council's reporting procedures and covers the treasury activity for 2009/10. The report also covers the actual Prudential Indicators for 2009/10 in accordance with the requirements of the Prudential Code.

2. BACKGROUND

2.1 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;
- 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.

2.2 This Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code and the above requirements. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis.

2.3 The Code requires as a minimum the regular reporting of treasury management activities to:

- Forecast the likely activity for the forthcoming year (in the Annual Treasury Strategy Report);
- Review activity in an interim annual report; and
- Review actual activity for the proceeding year (this report).

2.4 This report sets out the information in the following appendices: -

Appendix 1

- A summary of the treasury strategy agreed for 2009/10;
- A summary of the economic factors affecting the strategy over 2009/10;
- The decisions taken and performance of the treasury service and their revenue effects;
- The Council's treasury position at 31 March 2010;

Appendix 2

- The main Prudential Indicators and compliance with limits;
- Performance indicators set for 2009/10;
- Risk and performance.

3. CRIME AND DISORDER, ENVIRONMENTAL AND EQUALITY & DIVERSITY IMPLICATIONS

3.1 None arising directly from this report.

4. REVIEW PANEL COMMENTS

The Corporate Overview Panel noted the report and agreed that the performance achieved was excellent. In considering the matter the Panel noted that regulations require the Treasury Management Strategy to be agreed by members annually. They have asked the Executive Director to consider the most appropriate way of achieving this in future, perhaps by reporting direct to Cabinet only rather than including the Panel.

5. PORTFOLIO HOLDER COMMENTS

The Finance and Efficiency Portfolio Holder supports the annual report on the Treasury Management Service and the Actual Prudential Indicators for 2009/10. He is pleased that the Council continues to be debt free and that it is forecast to remain so.

6. RECOMMENDATIONS

The Cabinet are recommended to note this report.

For Further Information Please Contact:

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Background Papers:

The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance

Published Papers

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TREASURY MANAGEMENT STRATEGY - AMENDMENT REPORT

1. INTRODUCTION

1.1 Members are being asked to note the Annual Report on the Treasury Management Service and Actual Prudential Indicators 2009/10 on this agenda.

2. AMENDMENTS TO THE TREASURY STRATEGY 2010

2.1 Since the Treasury Strategy Report 2010/11 was written the investment situation has changed.

2.2 It would be beneficial to the Council's investment operation if the Investment Strategy was amended to expand the counterparty limits.

3. RECOMMENDATIONS

3.1 It is recommended that the following amendments be made to the Investment Strategy:-

3.1.1 Increase the counterparty limit for Barclays Bank, Lloyds TSB Bank and Nationwide Building Society from £5m to £10m;

3.1.2 Whilst retaining the general rule that the maximum that can be invested with any one counterparty at any one time be 20% of the total investment an exception to be made if the investment is with Barclays Bank, Lloyds TSB Bank and Nationwide Building Society in which case it may be 100% of core funds subject to the £10m counterparty limit;

3.1.3 Increase the limit that can be invested with the Money Market Fund (MMF) and with the Debt Management Office (DMO) from £5m to £10m for each; and

3.1.4 Include the CCLA (Church, Charity and Local Authority) investment instruments in the list of authorised investment counterparties.

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Background Papers:

APPENDIX 1

TREASURY MANAGEMENT PERFORMANCE - 1 APRIL 2009 TO 31 MARCH 2010

1. INTRODUCTION

This appendix sets out the performance for the Council's treasury management activities.

2. TREASURY STRATEGY SUMMARY FOR 2009/10

2.1 Borrowing Strategy

The borrowing strategy for 2009/10 indicated that: -

- Bank base rates would average 1.0% for the year;
- Long-term borrowing to meet capital expenditure would not be undertaken as the preference expressed by Members was that the Council should remain debt-free for the time being;
- The Council would borrow temporarily only for cash flow purposes;
- Interest payments would be £35,000.

2.2 Investment Strategy

The investment strategy for 2009/10 assumed that: -

- investments would be made for medium term periods with fixed rates to lock in good value and security of return if opportunities arose, subject to over riding credit counterparty security;
- Interest earnings on the Council's temporary cash flow investments would be £660,500. This was total earnings of £680,000 less statutory interest of £19,500 transferred from the Housing Revenue Account;

3. SUMMARY OF ECONOMIC FACTORS

3.1 During the year the financial sector staged a gradual recovery from the crisis seen in 2008/09 but still had a long way to go. The economy had been shaken, public sector finances were unhealthy, the UK's sovereign credit rating was in question and ultra-low money market rates amplified the difficulty of managing funds in a productive way.

3.2 The year opened on a very uneasy note. While emergency packages had been launched the previous autumn, all financial institutions were still considered highly vulnerable.

3.3 With official interest rates in the US already at close to zero, the Bank of England had reduced the Bank Base Rate to the historically low level of 0.5% in March 2009. The governor of the Bank indicated that no further cuts were contemplated and the rate stayed at this level for the whole of the 2009/10 financial year.

3.4 Quantitative Easing measures were adopted where the stock of money in the UK would be expanded via a mechanism of buying securities from investment institutions in exchange for cash.

3.5 Economic data confirmed that the UK was in deep recession and GDP growth sank to a low of minus 6%, well below even the most pessimistic forecasts. Mounting expectations of rapidly declining activity and projections of negative retail price inflation were seen as justifying the shift to a more aggressive approach to monetary policy.

3.6 The uncertainty in the UK and the financial markets caused a retraction in overall money market liquidity. While the situation improved as the year progressed, the margin between official interest rates and those quoted in the money market for periods longer that 1-month remained very wide.

3.7 In the spring, economies showed tentative signs of stabilising but a return to positive growth was still considered to be a long way off. The GDP data for the first half of 2009 registered its sharpest fall for over 20 years.

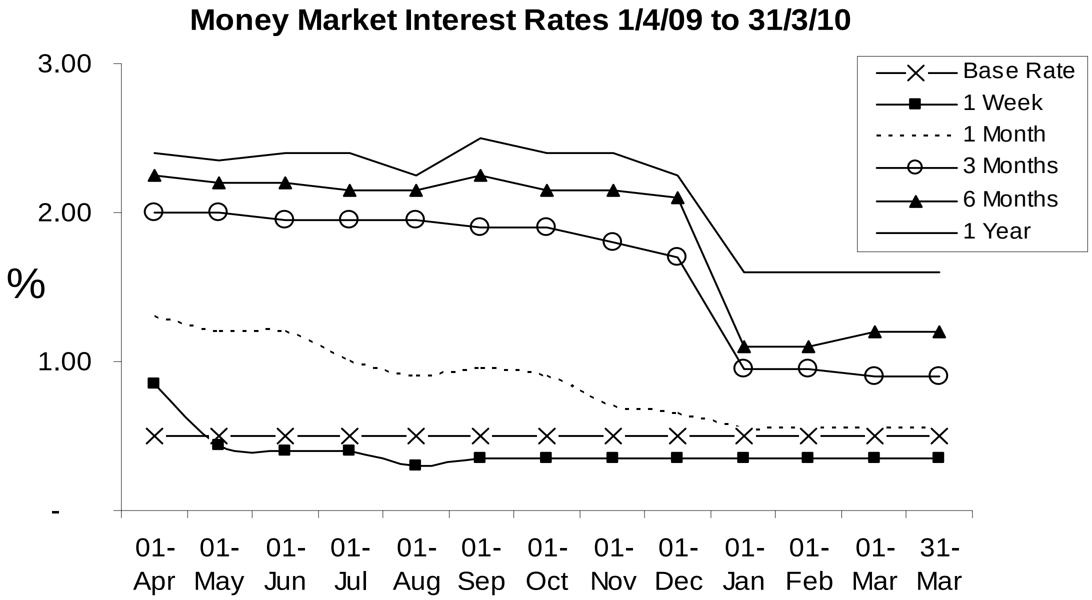
3.8 It was not until the summer months that economic performances began to stage an improvement. However, banking sectors in most countries were far from trouble free; minor US banks continued to fail and the troubles of a number of building societies resulted in mergers.

3.9 The household sector tried to reduce its heavily indebted position. This, along with the continued deterioration in the employment situation and the weakness of earnings growth, constrained spending.

3.10 Monetary Policy Committee decisions supported the continual easing of policy throughout the year. In the main, this took the form of the extension of the Quantitative Easing programme with the £125bn tranche sanctioned in March, followed by two further boosts, £50bn in August and £25bn in November.

3.11 Receding fears of financial collapse, increased money market liquidity and rates eased to lower levels. This was a sign that banks were more willing to transact business with each other but the availability of credit to a wider cross-section of the economy remained problematic through to the end of the year.

3.12 The following chart shows how the effect of all of these issues reduced market interest rates over the year.



3.13 The movements in the bank base rate during the year were as follows:

Date	Bank Base Rate
At 1 April 2009	0.50%
31 March 2010	0.50%

3.14 Analysts forecast that interest rates may begin to rise in the first quarter of 2011. It is likely that initial increases will be small in order to retain some stability in the economy.

4. LONG-TERM BORROWING

4.1 The Council had no existing long-term borrowing at 1 April 2009 and no long-term loans were raised during the year.

5. TEMPORARY BORROWING AND INVESTMENT

5.1 Borrowing

There were no temporary loans outstanding on 1 April 2009.

Six temporary loans were raised during the year for cash flow purposes. The loans were for periods up to 5 days and for amounts up to £3.581m.

Interest payments were £253 for temporary borrowing during the year.

There were no temporary loans outstanding at 31 March 2010.

5.2 Temporary Cash flow Investment

5.2.1 The original estimate for 2009/10 for interest receivable on temporary investments was £660,500 based on an anticipated earnings benchmark of 2.09% for the year. The actual interest receivable was £658,670 with an average interest rate of 2.05%; a variation of £1,830.

5.2.2 The cause of this variation was due to two factors:-

		£
	Original estimate for temporary investments earnings	660,500
a.	Lower Interest rate than forecast	-12,640
b.	Effect of rephased expenditure or savings	10,810
		658,670

5.2.3 Variations were reported to Cabinet during the year as part of the variation on the overall net interest earnings.

5.2.4 The actual interest earned on temporary investments for the year was equivalent to an annual rate of return of 2.05%.

5.2.5 All temporary investments had been made in accordance with the parameters set within the Council's Treasury Policy Statement.

5.2.6 The table below shows the list of temporary investments at 31 March 2010.

Borrower	**Amount £**	**Interest Rate %**
Nationwide BS	1,000,000	6.59
Nationwide BS	1,000,000	6.60
Skipton BS	1,000,000	7.00
National Counties BS	1,000,000	0.90
Manchester BS	1,000,000	1.00
Nottingham BS	2,500,000	0.95
Marsden BS	1,000,000	1.30
Market Harborough BS	1,000,000	1.20
Darlington BS	1,000,000	1.08
Saffron BS	1,000,000	1.30
Newbury BS	1,000,000	1.00
Principality BS	2,500,000	0.82
Kent Reliance BS	1,000,000	0.95
Norwich & Peterborough BS	2,500,000	0.90
Money Market Fund - IGNIS	1,200,000	0.64
Lloyds Treasury Call Account	250,000	0.15
Total	**19,950,000**	

6. BENCHMARKING

6.1 A temporary arrangement was put in place by this council, in response to nervous investment markets, where investments other than those with banks with a credit rating of “A” or higher were limited to a maximum, investment duration of 3 months.

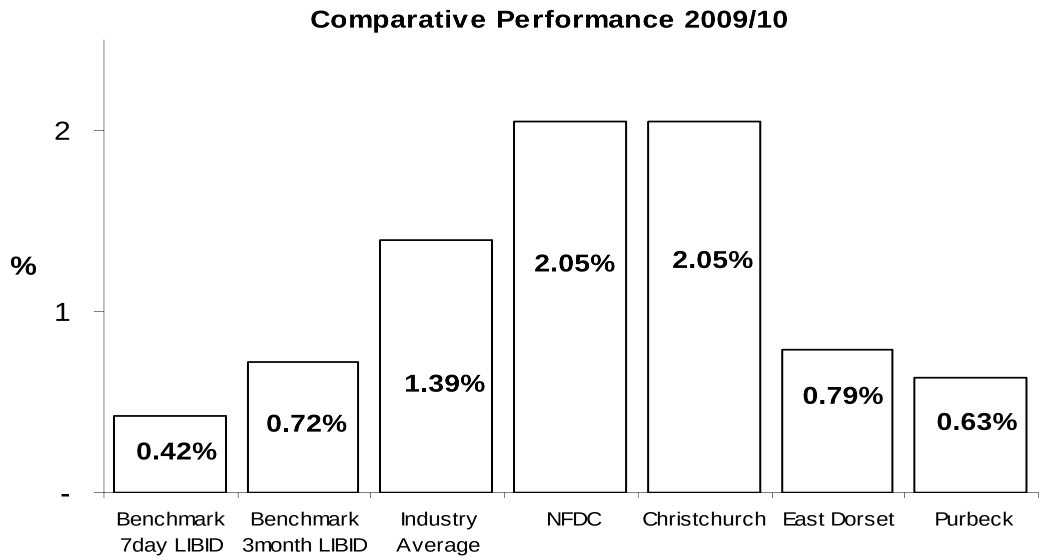
6.2 In order to measure the performance of the Council’s investments it is necessary to compare the earnings to a benchmark. The benchmark is established by taking a daily figure published by the money markets and averaging this over the period being measured. In this case the interest rate paid for 7 day money at the London Interbank Bid (LIBID) rate is averaged over one year. The LIBID rate is the rate that major UK banks will pay for money deposits on the London Interbank market.

6.3 The average rate of 7 day LIBID, the interest rate used for benchmarking the Council’s interest earnings for 2009/10, was 0.42%. Therefore, the interest earned on temporary investments exceeded the benchmark.

6.4 In addition to benchmarking to the London Money Market interest rates Members have requested a comparison of interest earnings to be made with other councils. All councils develop their own investment criteria and each differs either in the permitted period of investment, the institutions that deposits can be placed with or the limit to which funds can be invested with each organisation. These criteria are also often based on the overall value of funds available for investment within each council. It should be noted that the other councils used in this example have different investment parameters to NFDC and therefore direct comparison is difficult. For example Purbeck District Council relies heavily on investments with the Debt Management Office which pays very low rates of interest but is backed by central government and so deemed a very “safe” investment. East Dorset District Council’s investments are generally for one or two months in duration while Christchurch Borough Council can invest for longer periods. Both Christchurch and NFDC had investments running during 2009/10 which paid in excess of 6.5% and which were longer term deposits that had been made during spring 2008.

6.5 It is interesting to note the widely differing rates of return given the variation in investment parameters.

6.6 The following table shows the average earnings for this council's temporary investments against those of 7 day LIBID, 3 month LIBID, external fund managers' industry average and other councils.



6.7 The performance of this Council's treasury function was better than the benchmarks and the fund managers' industry average.

6.8 Results to 31 March 2010 are summarised as follows: -

	NFDC Temporary interest earnings %	Fund Manager industry average %
Actual Return	2.05	1.39
Benchmark Return	0.42	0.42
	£000	**£000**
Actual Return	659	447
Benchmark Return	135	135
Return above/(-)below benchmark	524	312

6.9 The value of the interest earned by NFDC on temporary investment as at 31 March 2010 was £524,000 above the benchmark figure as shown at paragraph 6.8. These earnings were also £212,000 higher than the fund manager industry average.

7. INVESTMENT PORTFOLIO STRATEGY

Funds are invested in cash deposits.

At the start of the year the portfolio was invested in instruments with interest rates averaging 3.91%.

At the beginning of the year the anticipation was that interest rates would remain stable. Base rates stayed at 0.50% for the year as forecast but period money rates fell as shown at table 3.12 above.

The main reasons for the reduction in the money market period interest rates were that institutions didn't have a significant borrowing need as they were granting fewer mortgages in a stagnant housing market and any funds that were needed were supplied to a greater extent by retail deposits as people sought to save instead on spend.

During the year it was, on occasion, difficult to deposit money with a suitable institution that met all of the council's criteria. A Money Market Fund was set up during the year to aid this situation. The fund is AAA rated and the council had instant access to all deposits. The interest rate was not as good as period deposits of 2 months or more but was much better than the Government's Debt Management Account Deposit Facility. This fund was used for very short term deposits or where other investment limits had been reached.

The portfolio of investments was held in deposits earning an average of 1.8% at the year end. The average rate will reduce through 2010/11 assuming that the period rates remain unchanged and, as investments mature, are replaced with those of a lower return.

8. TREASURY POSITION AT 31 MARCH 2010

The following table shows the treasury position at the 31 March 2010 compared with the previous year.

	31 March 2009		31 March 2010	
	Principal	**Average Rate**	**Principal**	**Average Rate**
	£m	**%**	**£m**	**%**
Variable Interest Rate				
- Money Market Funds	£0.00m	0.0%	£1.20m	0.6%
- Call Account	£0.05m	0.1%	£0.25m	0.2%
	£0.05m	0.1%	£1.45m	0.5%
Fixed Interest Rate				
- Temporary Investments	£17.50m	3.4%	£18.50m	1.9%
- Long Term Investments	£3.00m	6.7%	£0.00m	0.0%
	£20.50m	3.9%	£18.50m	1.9%
Total Investments	**£20.55m**	**3.9%**	**£19.95m**	**1.8%**

APPENDIX 2

PRUDENTIAL INDICATORS AND COMPLIANCE ISSUES TO 31 MARCH 2010

1. INTRODUCTION

1.1 The Council is required by the Prudential Code to report the actual prudential indicators after the year-end.

1.2 The following table, at Paragraph 2, provides a schedule of all the mandatory prudential indicators.

1.3 Certain of these indicators must be compared to others and are detailed later in this appendix.

2. ESTIMATED AND ACTUAL TREASURY POSITION AND PRUDENTIAL INDICATORS

2.1 The following table compares the actual figure for 2009/10 with the original indicator for 2009/10 and the actual figure for 2008/09.

2.2 The original indicator for 2009/10 is the same as was included in the Treasury Strategy Report 2009/10.

		2008/09 Actual **£000**	**2009/10 Original Indicator** **£000**	**2009/10 Actual** **£000**
1	**Capital Expenditure**	12,668	12,084	10,845
2	**Capital Financing Requirement (CFR) at 31 March** Housing Non Housing **Total**	 1,897 4730 **6,627**	 1,897 5,375 **7,272**	 1,897 4,710 **6,607**
3	**Treasury Position at 31 March** Borrowing Other long term liabilities **Total Debt** Investments **Net Borrowing/Investments (-)**	 0 0 **0** 20,550 **-20,550**	) 0 **)** 0,400 **10,400**	 0 0 **0** 19,950 **-19,950**
4	**Authorised Limit** (against maximum position)	**Maximum** 2,000	**Maximum** 27,000	**Maximum** 3,581
5	**Operational Boundary** (maximum measured against average position)	**Maximum** 2,000	**Average** 2,000	**Maximum** 3,581
6	**Ratio of financing costs to net revenue stream**	2%	1.4%	0.5%
7	**Incremental impact of capital investment decisions on the Band D council tax**	£ 6.25	£ 4.45	£ 1.30

8	**Incremental impact of capital investment decisions on the housing rent levels**	£ 0.76	£ -2.46	£ -2.93
9	**Upper limits on fixed interest rates** (against maximum position)	**Maximum** 100%	**Maximum** 100%	**Maximum** 99%
10	**Upper limits on variable interest rates** (against maximum position)	**Maximum** 8**%**	**Maximum** 50%	**Maximum** 17%
11	**Maturity structure of fixed rate borrowing** (against maximum position)			
	Under 12 months	100%	**Upper Limit** 100%	100%
	12 months to 2 years	0%	100%	0%
	2 years to 5 years	0%	100%	0%
	5 years to 10 years	0%	100%	0%
	10 years and above	0%	100%	0%
12	**Maturity structure of variable rate investments** (against maximum position)			
	Under 12 months	100%	**Upper Limit** 100%	100%
	12 months to 2 years	0%	50%	0%
	2 years to 5 years	0%	50%	0%
13	**Maximum principal funds invested** (against maximum position)	**Maximum** 47,015	**Maximum** 46,500	**Maximum** 46,594

2.3 Any indicators that were exceeded were guideline limits only. There were no breaches of statutory limits during the year.

2.4 In addition to the above the Council is required as a Prudential Indicator to:

- Adopt the CIPFA Code of Practice. The compliance for this indicator is shown at paragraph 2.2 in the body of the report.

- Ensure that over the medium term borrowing will only be for a capital purpose (i.e. net external borrowing is less than the CFR). The compliance for this indicator is shown at paragraph 3.1 below.

3. LIMITS TO BORROWING ACTIVITY

3.1 Net external borrowing

	31 March 2009 Actual	31 March 2010 Original Indicator	31 March 2010 Actual
Net borrowing position	**-£20.6m**	**-£10.4m**	**-£20.0m**
Capital Financing Requirement	**£6.6m**	**£7.3m**	**£6.6m**

The Capital Financing Requirement (CFR) shows the Council's underlying need to borrow for a capital purpose, and this is an indication of the Council's debt position. In order to ensure that borrowing net of investments will only be for a capital purpose, net borrowing should not exceed the CFR for 2009/10.

The table above shows that the Council has complied with this requirement.

3.2 Borrowing Limits

	2009/10
Authorised Limit	**£27.0m**
Operational Boundary	**£2.0m**
Maximum gross borrowing position during the year	**£3.6m**
Average gross borrowing position during the year	**£0.1m**
Minimum gross borrowing position during the year	**£0.0m**

The Authorised Limit must not be breached. The table demonstrates that during 2009/10 the Council has maintained gross borrowing within its Authorised Limit.

The Operational Boundary is the expected average borrowing position of the Council during the year, and periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

4. TREASURY SERVICE PERFORMANCE INDICATORS FOR 2009/10

The treasury service has set the following performance indicators:

- The return on interest earnings should be higher than a benchmark of the 7-day LIBID rate averaged over the year.

5. RISK AND PERFORMANCE

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

5.2 The Council is aware of the risks of passive management of the treasury portfolio and has proactively managed the investments over the year within the constraints of the investment guidelines.

5.3 Shorter-term market rates and likely future movements of interest rates predominantly determine the Council’s investment return. These returns can therefore be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

5.4 Section 6 of appendix 1 shows the returns for 2009/10.