Agenda Item No 5

TEESDALE DISTRICT COUNCIL

Report To: **EXECUTIVE COMMITTEE**
8 September 2008

From: Lead Member for Resources: Councillor G K Robinson

Ward Member: All

Subject: **TREASURY MANAGEMENT ANNUAL REPORT 2007/08**

1.0 SUMMARY

1.1 This report summarises the treasury management activity in respect of the financial year 2007/08 and provides details of performance against targets and limits.

2.0 RECOMMENDATION(S)

2.1 It is recommended that

2.1.1 The actual 2007/08 prudential indicators are approved and

2.1.2 The treasury management stewardship report for 2007/08 is received.

3.0 LINK TO CORPORATE KEY PRIORITIES/AMBITIONS

3.1 Priority: Improvement Programme

3.2 Ambition: Maximising Resources

3.3 Outcome: Actual performance is measured against targets and expectations.

4.0 BACKGROUND

4.1 The annual treasury report is a requirement of the Council's reporting procedures. It covers the treasury activity and the actual prudential indicators for 2007/08.

4.2 This report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both codes through regulations issued under the Local Government Act 2003.

5.0 ANNUAL REPORT 2007/08

5.1 During 2007/08 the Council complied with all legislative and regulatory requirements. The detailed treasury management annual report is attached at Appendix A, but the key actual prudential indicators for the year, with comparators, are shown below.

Actual Prudential Indicators	2006/07 £m	2007/08 £m
Actual Capital Expenditure	1.192	0.980
Capital Financing Requirement Non-HRA HRA Total	 3.170 - 3.170	 1.125 - 1.125
Financing Costs as a proportion of net revenue stream	2.3%	-7.1%

5.2 The Council operated within both the authorised limit and the operation boundary in respect of borrowing. Borrowing was only undertaken for a capital purposes. Further details are contained in paragraph 5 of the treasury management annual report attached at Appendix A.

5.3 At 31 March 2008, the Council's external debt was £2.089m (£3.915m at 31 March 2007) and its investments totalled £2.500m (£3.500m at 31 March 2007).

6.0 STATUTORY CONSIDERATIONS

6.1 Financial Implications: None

6.2 Risk:

Risk	Category	Implications
Returns on investments are not maximised/costs of borrowing are not minimised	Financial	Cost/reduced income for the General Fund
Amounts invested are not safeguarded	Financial	Potential cost to the General Fund
The Council does not comply with treasury management guidance	Regulatory, Reputational	Criticism and potential qualification of the accounts by external auditors

6.3 Equality and Diversity: None

6.4 Human Resources: None

6.5 Community Safety: None

6.6 Legal Issues:

The Council is required to comply with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities in accordance with the Local Government Act 2003.

Background papers:

1. Treasury Management Policy – Administration & Governance Committee 1 October 2003
2. Treasury Management Manual – Corporate Services Committee 16 February 2005
3. Treasury Management Strategy 2007/08 to 2009/10 – Executive Committee 12 February 2007

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APPENDIX A

Annual Report on the Treasury Management Service and Actual Prudential Indicators 2007/08

1. Introduction

1.1. This report summarises:

- the capital activity for the year;
- how this activity was financed;
- the impact on the Council's indebtedness for capital purposes;
- the Council's overall treasury position;
- the reporting of the required prudential indicators;
- a summary of interest rate movements in the year;
- debt activity; and
- investment activity.

2. The Council's Capital Expenditure and Financing 2007/08

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

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

2.2. 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 wider treasury activities also include managing the Council's cash flows, its previous borrowing activities and the investment of surplus funds. These activities are structured to manage risk foremost, and then optimise performance. Wider information on the regulatory requirements is shown in Section 11.

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

£m	2006/07 Actual £m	2007/08 Estimate £m	2007/08 Actual £m
Non-HRA capital expenditure	0.534	1.673	0.980
HRA capital expenditure	0.658	-	-
Total capital expenditure	**1.192**	**1.673**	**0.980**
Resourced by:			
Capital receipts	0.441	0.120	0.125
Capital grants	0.441	0.197	0.312
Capital reserves	-	-	-
Revenue	-	-	0.011
Unfinanced capital expenditure (additional need to borrow)	**0.310**	**1.356**	**0.532**

3. The Council's Overall Borrowing Need

3.1. 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 2007/08 and prior years net capital expenditure which has not yet been paid for by revenue or other resources.

3.2. The Non-HRA element of the CFR is reduced each year by a statutory revenue charge called the Minimum Revenue Provision (MRP). The total CFR can also be reduced by:

- the application of additional capital resources such as unapplied capital receipts; or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

With effect from 1 April 2008 the CLG introduced new MRP Guidance which requires an MRP Policy to be approved by Members. This new policy was approved on 11 February 2008 by the Executive Committee.

3.3. The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR (£m)	31 March 2007 Actual	31 March 2008 Original Indicator	31 March 2008 Actual
Opening balance	5.666	3.234	3.234
+ unfinanced capital expenditure	0.310	1.356	0.532
- MRP/VRP/Other *	-3.806	-2.641	-2.641
Closing balance	**3.170**	**1.949**	**1.125**

4. Treasury Position at 31 March 2008

4.1. Whilst the Council's gauge of its underlying need to borrow is the CFR, the Chief Finance Officer and the treasury function can manage the Council's actual borrowing position by either:

- borrowing to the CFR; or
- choosing to utilise some temporary internal cash flow funds instead of borrowing (under-borrowing); or
- borrowing for future increases in the CFR (borrowing in advance of need).

4.2. It should be noted that the accounting practice required to be followed by the Council in the SoRP changed in the 2007/08 accounts, and required financial instruments in the accounts (debt and investments etc.) to be measured in a method compliant with national Financial Reporting Standards. The figures in this report

are based on the amounts borrowed and invested and so may differ form those in the final accounts by items such as accrued interest.

4.3. During 2007/08 the Chief Finance Officer managed the debt position to £2,088,771, a net reduction of £1,826,056 against the opening position. This reduction was due to a further repayment of debt (£2,511,459) relating to the housing stock transfer completed in 2006 and additional borrowing of £687,000 to finance capital expenditure.

4.4. The treasury position at the 31 March 2008 compared with the previous year was:

Treasury position	**31 March 2007**		**31 March 2008**	
	Principal	**Average Rate**	**Principal**	**Average Rate**
Fixed Interest Rate Debt	£3.915m	4.581%	£2.089m	4.535%
Total Debt	**£3.915m**	**4.581%**	**£2.089m**	**4.535%**
Fixed Interest Investments	£3.500m	4.98%	£2.500m	5.736%
Variable Interest Investments	-	-	-	-
Total Investments	**£3.500m**	**4.98%**	**£2.500m**	**5.736%**
Net borrowing position	**£0.415m**		**-£0.411m**	

5. Prudential Indicators and Compliance Issues

5.1. Some of the prudential indicators provide either an overview or specific limits on treasury activity. These are shown below:

5.2. **Net Borrowing and the CFR** - In order to ensure that borrowing levels are prudent over the medium term the Council's external borrowing, net of investments, must only be for a capital purpose. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2007/08 plus the expected changes to the CFR over 2008/09 and 2009/10. The table below highlights the Council's net borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2007 Actual	**31 March 2008 Original Indicator**	**31 March 2008 Actual**
Net borrowing position	**£0.415m**	**-£0.657m**	**-£0.411m**
CFR	**£3.170m**	**£1.949m**	**£1.125m**

5.3. **The Authorised Limit** - The Authorised Limit is the 'Affordable Borrowing Limit' required by s3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2007/08 the Council has maintained gross borrowing within its Authorised Limit.

5.4. **The Operational Boundary** – The Operational Boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the Boundary is acceptable subject to the Authorised Limit not being breached.

5.5. **Actual financing costs as a proportion of net revenue stream** - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2007/08
Original Indicator - Authorised Limit	**£4.665m**
Maximum gross borrowing position	**£3.915m**
Original Indicator - Operational Boundary	**£3.915m**
Average gross borrowing position	**£3.002m**
Financing costs as a proportion of net revenue stream	**-7.07%**

6. Economic Background for 2007/08

6.1. The rising trend in UK interest rates continued in the first half of the 2007/08 financial year. The domestic economic backdrop continued to present problems for the Monetary Policy Committee, notably in the early summer. CPI inflation breached the 3% upper limit of the Government's target range in April, consumer spending growth remained buoyant and an expanding number of companies expressed intentions to raise prices.

6.2. Official Bank Rate was raised to 5.5% in May and 5.75% in July in response to the deteriorating inflation outlook. In addition, the Bank of England's May and August Inflation Reports hinted that more hikes might be necessary.

Interest Rates

End Qtr	Bank Rate	LIBOR			PWLB Rates		
		3mth	6mth	1yr	5yr	20yr	50yr
2007 Mar	5.25	5.6	5.8	5.9	5.35	4.80	4.45
Jun	5.50	6.0	6.1	6.3	5.80	5.20	4.80
Sep	5.75	6.3	6.3	6.2	5.25	5.00	4.75
Dec	5.50	6.0	6.0	5.8	4.64	4.63	4.47
2008 Mar	5.25	6.0	6.0	5.8	4.14	4.70	4.43

6.3. The market was plunged into chaos in late August as the tightening of credit conditions, triggered initially by the failure of a selection of American mortgage lending institutions, undermined investor confidence. LIBOR rates rose to well over 6.5% as financial organisations' reluctance to lend money to counterparties sparked a severe shortage of funds in the market. In the UK, the crisis came to a head with the failure of the Northern Rock Bank in September and while the danger of potential meltdown was defused by the Government's decision to guarantee all deposits with this institution, this failed to prevent a prolonged tightening of credit conditions.

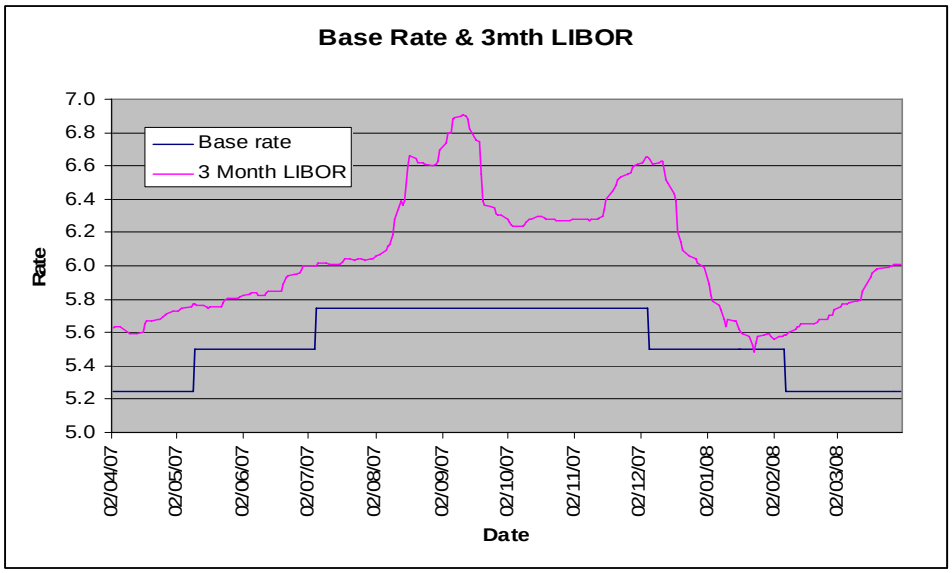
6.4. Central banks strove to boost market liquidity via the injection of funds to the banking system and there were signs that this might be working in January. However, a series of disappointing financial results and a persistent undercurrent of mistrust ensured a wide margin between official and market rates continued to year end.

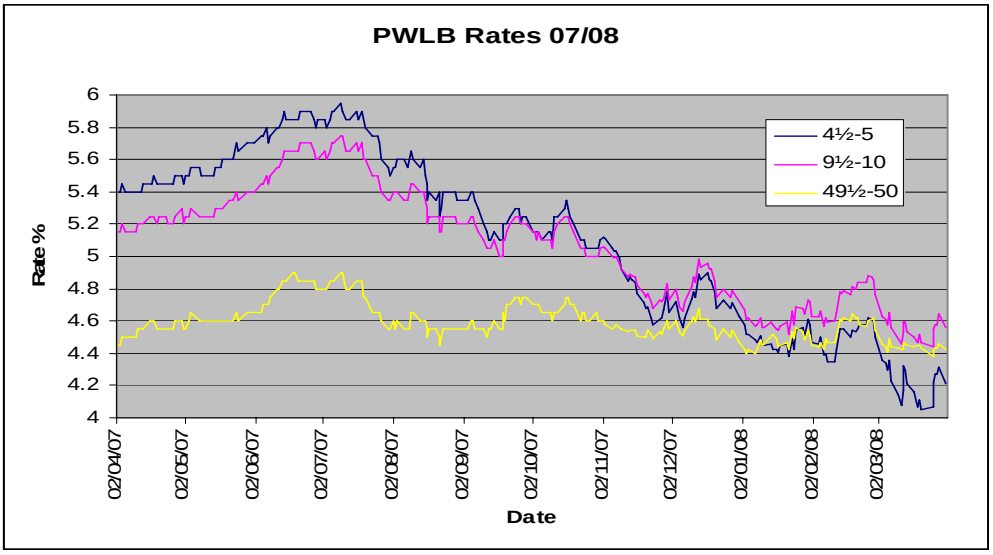
6.5. The credit crisis provoked a significant change in the Bank of England's assessment of UK economic prospects over the medium term. It was clearly concerned that the tightening of liquidity and the consequent rise in borrowing rates across the entire economy could lead to a rapid slowdown in activity. The Bank of England's base rate was cut by 0.25% on two occasions, December and February, to end the year at 5.25%.

6.6. Long-term rates (gilt yields & PWLB rates) charted an erratic course. The upward pressure on rates in evidence in the closing stages of 2006/07 continued into the new year as concerns persisted that international interest would need to rise further to combat mounting inflation pressures.

6.7. Gilt yields peaked in late June and started to slip lower in the summer months. The flight to safe investments triggered by the financial crisis placed strong downward pressure upon gilt-edged yields in August/September notably at the short end of the maturity range and the rally in this part of the market gained momentum as the year drew on.

6.8. Progress to lower levels was erratic and limited in the early months of 2008, but the general trend in yields was to lower levels. The most notable development was the reversion of the yield curve to a strongly-positive incline.





7. The Strategy Agreed for 2007/08

7.1. The strategy for 2007/08 initially expected that there would be no borrowing, with the housing stock transfer capital receipt being used to finance capital expenditure. This strategy was revised in August when borrowing of £709,755 for the year was anticipated at a rate of 4.9%.

7.2. Investment activity was expected to remain constant throughout the year with approximately £3m of balances available on average with a return of approximately 5%.

8. Actual debt management activity during 2007/08

8.1. **Borrowing** – a loan was drawn to finance the net capital spend as follows:

Lender	Principal	Type	Interest Rate	Maturity	Average for 2007/08
PWLB	£0.687m	Fixed interest rate	4.450%	45.5 years	4.62%

8.2. This compares with a budget assumption of borrowing at an interest rate of 4.9%.

8.3. **Rescheduling** – No rescheduling was undertaken in 2007/08.

8.4. **Repayment** - On 5 July 2007 debt of £2.511m was repaid, representing the remaining housing capital financing requirement, generating a discount of £189,085. The debt was repaid using the balance of the capital receipt arising from the sale of the housing stock (£1.311m) and Over Hanging Debt Grant received from Communities and Local Government (£1.200m). This additional repayment was necessary to ensure that an equivalent amount of debt to the housing capital financing requirement had been repaid.

8.5. **Change of Policy** - In November 2007 the PWLB changed its structure of interest rates so that any repayment of PWLB debt will have a more penal repayment rate applied. As such the cost of any PWLB repayments will be higher in the future.

8.6. **Summary of Debt Transactions** – The overall position of the debt activity resulted in a fall in the average interest rate by 0.046%, representing a net General Fund savings of £961 p.a. based on the level of borrowing at 31 March 2008.

9. Investment Position

9.1. **Investment Policy –** The Council's investment policy is governed by ODPM (now DCLG) Guidance, which has been implemented in the annual investment strategy approved by Council on 28 February 2007. The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

9.2. **Resources –** The Council's longer term cash balances comprise primarily revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and meet the expectations of the budget:

Balance Sheet Resources	31 March 2007 £m	31 March 2008 £m
Balances	**1.202**	**1.373**
Earmarked reserves	**0.550**	**0.427**
Provisions	**-**	**0.004**
Usable capital receipts	**1.486**	**0.053**
Total	**3.238**	**1.857**

9.3. **Investments Held by Fund Managers -** The Council does not use external fund managers as part of its investment strategy.

9.4. **Investments Held by The Council** - The Council does not have the expertise or resources to actively use a wide range of investment products and therefore performance tends to be more stable but lower over the longer term than for professionally managed funds whose performance may fluctuate more. The Council maintained an average balance of £4.829m and received an average return of 5.84%. The comparable performance indicator is the average 7-day LIBID rate, which was 5.59%. This compares with a budget assumption of £2.978m investment balances at 5% interest rate.

9.5. The Council's investment programme has now contributed over £1.070m to the General Fund to support revenue since 1998, with more than £716,000 of this achieved in the last 3 years.

10. Performance Indicators set for 2007/08

10.1. This service has set the following performance indicators :

- Debt – Average rate of borrowing for the year (4.45%) compared to average available (4.62%)
- Debt – Average rate movement year on year was a reduction of 0.046% from 4.581% to 4.535%
- Investments – Internal returns above the 7 day LIBID rate, achieved 5.84% against average of 5.59%

11. Regulatory Framework, Risk and Performance

11.1. 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 2007/08);
- 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 ODPM (now 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 8th November 2007.

11.2. The Council has complied with all of the above relevant statutory and regulatory requirements which 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 both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

11.3. The Council is aware of the risks of passive management of the treasury portfolio and, with the support of Butlers, the Council's advisers, has proactively managed its treasury position. The Council has continued to utilise historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly fixed, utilising long-term loans.

11.4. Shorter-term rates and likely future movements in these 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.

Average Rates for the Comparison Borrowing Table

Average Fixed Maturity Interest Rates for the PWLB over 2007/08 (%)

	4½-5	9½-10	14½-15	19½-20	24½-25	29½-30	34½-35	39½-40	44½-45	49½-50	50+
Average	5.11	5.07	5.06	4.95	4.83	4.73	4.68	4.65	4.62	4.59	4.59
High	5.95	5.75	5.70	5.50	5.30	5.15	5.05	5.00	4.95	4.90	4.85
Low	4.05	4.44	4.55	4.51	4.45	4.41	4.39	4.40	4.39	4.38	4.41

Average Variable Rates for the PWLB over 2007/08

1-M Rate	3-M Rate	6-M Rate
5.71	5.70	5.70